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TARGET LITIGATION†

*Michael Rosenzweig**

Commentators have written a great deal in recent years about management resistance to takeover bids. Some believe that management's decision to oppose a tender offer is an ordinary business judgment, entitled to the protection of the "business judgment rule."[1] Others claim that target company management ought not be afforded such latitude, arguing that this application of the business judgment rule is illogical, inconsistent with Congress' goals in adopting the Williams Act, and, given the functions performed by tender offers, ultimately unwise.[2]

Participants in this debate have generally avoided very close scrutiny of particular defensive tactics employed by target managements. Thus while the literature addresses, in a rather cursory way, the propriety of certain defenses,[3] most of the discussion focuses on the broad question of management resistance in general. There is, in particular, little analysis of litigation against the tender offeror,[4] a tactic that tar-

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1. *See, e.g.,* Lipton, *Takeover Bids in the Target's Boardroom,* 35 BUS. LAW. 101 (1979); Lipton, *Takeover Bids in the Target's Boardroom: An Update After One Year,* 36 BUS. LAW. 1017 (1981) [hereinafter Lipton II]; Herzel, Schmidt & Davis, *Why Corporate Directors Have a Right to Resist Tender Offers,* 3 CORP. L. REV. 107 (1980); Lipton, *Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook and Fischel,* 55 N.Y.U. L. REV. 1231 (1980); *see also* authorities cited at note 155 *infra.*

2. *See, e.g.,* Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer,* 94 HARV. L. REV. 1161 (1981); Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers,* 57 TEXAS L. REV. 1 (1978); Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers,* 33 STAN. L. REV. 819 (1981).

3. *See, e.g.,* Gilson, *supra* note 2, at 826-31. *But see* Bradley & Rosenzweig, *Defensive Stock Repurchases,* 99 HARV. L. REV. 1377 (1986) (providing extended analysis of one defensive tactic, target stock repurchases).

4. Some commentators, for example, almost casually lump target litigation together with other takeover defenses they would simply *bar* as inimical to shareholder welfare. *See, e.g.,* Easterbrook & Fischel, *supra* note 2, at 1192-94; *see also* Gilson, *supra* note 2, at 878-79. In a recent article, however, Gregg Jarrell did examine the impact of target litigation on the wealth of target shareholders. Jarrell, *The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge?,* 28 J.L. & ECON. 151 (1985). I discuss Jarrell's analysis at notes 92-143 *infra* and accompanying text.

get managers commonly employ[5] with considerable effectiveness.[6] My purpose here is to fill this void by analyzing the use of such litigation by target company managements.

It is well known, of course, that target managers commonly respond to unwanted takeover bids[7] by suing the bidder.[8] But why, exactly, do target managers sue? Gregg Jarrell, until recently Chief Economist of the Securities and Exchange Commission, believes that they may do so in order to get a better deal for their shareholders. Thus, he has suggested that "the goal of [litigious] target management is to increase the takeover price.... [M]ost target litigation should be viewed as a value-maximizing gamble undertaken by managers in the best interests of their shareholders."[9]

Jarrell's thesis is important and provocative, for it suggests that a very common takeover defensive measure — litigation — should be viewed favorably by those concerned with the welfare of target shareholders. In this respect, he contradicts the claims of others that target management's freedom to resist hostile bids should be severely curtailed.[10]

In this Article, I shall offer a view of target litigation quite different from Jarrell's. I argue that target managers generally sue bidders in order to thwart takeover attempts and, more important, often succeed, thus maintaining their control over the target. This result, I shall argue, is hardly in the best interests of target shareholders or, for that matter, society at large. I therefore conclude that target lawsuits

5. *See* notes 12-20 & 36-40 *infra* and accompanying text.

6. *See* notes 65-82 *infra* and accompanying text.

7. By "unwanted takeover bids," I mean those in which target management has announced its opposition. I also refer to such bids occasionally as "hostile," "contested," or "unfriendly" bids.

8. E. ARANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL 266-67 (1973); E. ARANOW, H. EINHORN & G. BERLSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL 104-92 (1977); 1 A. FLEISCHER, TENDER OFFERS: DEFENSES, RESPONSES, AND PLANNING 119-44 (2d ed. 1983 & Supp. 1985); 1 M. LIPTON & E. STEINBERGER, TAKEOVERS & FREEZEOUTS § 6.07 (1986); S. LORNE, ACQUISITIONS AND MERGERS: NEGOTIATED AND CONTESTED TRANSACTIONS § 4.05[3][b][i] (1985); *see also* notes 17-20 *infra* and accompanying text (describing empirical evidence of the frequency of target litigation).

Target lawsuits are many and varied. For example, targets often assert violations of federal and state securities laws, federal antitrust laws, federal margin requirements, federal and state change-of-control restrictions and, most recently, federal anti-racketeering laws. *See generally* E. ARANOW, H. EINHORN & G. BERLSTEIN, *supra*, at 107-93 (surveying target lawsuit claims and standing issues); 1 A. FLEISCHER, *supra*, at 144-47 (discussing target litigation under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 (1976 & Supp. V 1981). *See also* notes 37-41 *infra* and accompanying text.

9. Jarrell, *supra* note 4, at 152-53.

10. *See, e.g.,* Schwartz, *Search Theory and the Tender Offer Auction,* 2 J.L. ECON. & ORG. 229 (1986); Baron, *Tender Offers and Management Resistance,* 38 J. FIN. 331, 342 (1983); Easterbrook & Fischel, *supra* note 2, at 1198; Gilson, *supra* note 2, at 878-79; Bebchuk, *The Case for Facilitating Competing Tender Offers,* 95 HARV. L. REV. 1028, 1029 (1982).

should be viewed with suspicion and perhaps subjected to rules designed to limit the harm such lawsuits can cause.[11]

In Part I, I explore the motives of litigious target managers. I briefly examine the takeover defense literature and empirical evidence regarding the frequency of target litigation, both of which indicate that target managers usually sue bidders in order to defeat unwanted takeover attempts. I also suggest that judicial reactions to target lawsuits largely confirm this hypothesis.

I then discuss, in Part II, target management's conflict of interest in control contests and the particular strategic considerations that lead target managers to sue hostile bidders. I argue that target litigation is peculiarly likely to be frivolous and, based on a study of successful target defenses, show that litigation often repels unwanted bids. This result, empirical studies demonstrate, adversely affects target shareholder wealth and, I suggest, undermines an optimal allocation of corporate resources.

I conclude in Part III by proposing reforms that would limit harmful target litigation without unduly restricting the ability of target managers to seek redress for legally cognizable wrongs. I also suggest that the benefits that Jarrell attributes to target litigation can be preserved cheaply and effectively under the approach that I propose.

I. The Goal of Target Lawsuits: Why Do Target Managers Sue?

Plaintiffs ordinarily file lawsuits with the goal of obtaining relief from allegedly illegal conduct by defendants. One might therefore assume that targets sue bidders in order to prevent or remedy unlawful tender offers or tender offer practices. Nevertheless, there are a number of reasons for concluding that target managers often sue bidders in order to impede unwanted offers, with little concern whether their lawsuits assert meritorious legal claims. First, specialists in the strategy of control contests commonly urge the commencement of litigation as a means of thwarting unwanted tender offers. Indeed, the literature suggests that these specialists view target litigation as a virtually automatic response by any management team wishing to resist a takeover attempt.

For example, one lawyer observes that litigation against the bidder

11. Target lawsuits generally assert claims on behalf of the target company, not its managers individually. Nevertheless, these actions are usually instituted by managers as part of an overall strategy designed to defeat the takeover bid and thereby thwart their displacement as managers. *See* Part I *infra*. Thus, when I refer to target *management* lawsuits, I will be employing a shorthand that is technically inaccurate but arguably reflects the reality of target litigation against hostile bidders.

is "axiomatic." "[I]t's obviously something that always gets done . . . ."[12] Another notes that target managers

> almost always will run to court claiming that the [tender] offer is in violation of the Williams Act, the federal antitrust laws, and any other laws imaginative counsel can discover. . . .
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> . . . .
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> . . . [I]t has become a reflex action for a target company to combat an offeror by alleging violations of section 14(e) — the antifraud provision of the Williams Act. . . .
>
> . . . .
>
> . . . Antitrust claims are often raised whether or not the circumstances warrant it.[13]

Similarly, some have urged target managers to consider the use of defamation actions against the bidder's management "as a weapon in corporate control battles."[14] And even scholars further removed from the fray of control contests have stated flatly that "[o]ne of the most effective defensive strategies is to invoke the aid of courts."[15] In view of these examples, the following observation by the authors of a leading text on securities regulation seems apt: "Almost without exception, any announcement of a takeover bid is now instantly followed by an injunction action filed by the corporate management charging the

12. Wachtell, *Special Tender Offer Litigation Tactics,* 32 BUS. LAW. 1433, 1437 (1977). It is significant that the author is senior partner of a prominent law firm that specializes in mergers and acquisitions, particularly hostile tender offers.

13. Liman, *Has the Tender Movement Gone Too Far?,* 23 N.Y.L. SCH. L. REV. 687, 688, 689, 696-97 (1978). Liman describes "what seems to be the current prevailing philosophy of the Bar — namely, that filing a lawsuit at the commencement of a tender offer should be an 'automatic' response." *Id.* at 690 n.15.

Another pair of takeover specialists have stated that "it is the unusual case where some kind of lawsuit cannot be filed." Reuben & Elden, *How to be a Target Company,* 23 N.Y.L. SCH. L. REV. 423, 437 (1978). Nevertheless, these authors caution that targets "should not automatically sue in response to a tender offer. A target should not sue if it has no colorable claim . . . . Judges are becoming increasingly sophisticated about the use, and misuse, of lawsuits in tender offers . . . ." *Id.* at 437-38; *see* note 23 *infra.*

14. Arthur, Kirby & Rein, *Defamation Suits as a Weapon in Corporate Control Battles,* 37 BUS. LAW. 1 (1981). The authors decry the increased tendency of courts to hold that "state securities statutes are preempted by federal securities laws" and to read "federal securities and antitrust statutes less expansively," concluding that "participants in heated control battles have good reason to consider new litigation alternatives, including defamation actions." *Id.* at 3. The article is replete with examples suggesting the authors' attitude toward target litigation. They note, for instance, that "[i]n corporate control battles, initiation of litigation often is motivated as much by short term or tactical considerations as by the prospects of long-term relief on the merits." *Id.* at 8. Thus, they point out that "[a]lmost any plausible cause of action threatens [the] opponent with burden, delay, and expense," which they applaud as "a valuable means of enhancing an opponent's apparent level of risk." *Id.* at 11. Similarly, they extol the tactical value of "expedited and wide-ranging discovery" in takeover litigation, observing that quite apart from its relevance to the merits of the case, discovery "may provide insight into an opponent's tactics and useful 'ammunition' in the form of unfavorable information, and also may burden an opponent at a time of otherwise intense demands." *Id.* at 10.

15. Easterbrook & Fischel, *Antitrust Suits by Targets of Tender Offers,* 80 MICH. L. REV. 1155, 1155 (1982).

'raider' with most of the crimes in the Decalogue, but usually stopping short of statutory rape."[16]

Empirical studies of target litigation are consistent with the proposition that target managers often use lawsuits against the bidder as a tactical device for resisting an unwanted offer. For example, I conducted a study of takeover contests in which I examined management responses to tender offers over a recent three-and-a-half year period. In a sample of ninety-five hostile bids, I found that sixty (sixty-three percent) elicited target lawsuits following announcement of the tender offer.[17]

Similarly, in his recent article examining the effect of antitakeover litigation on the wealth of target shareholders, Gregg Jarrell reported that targets litigate in at least one-third of *all* takeover attempts, in-

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16. R. JENNINGS & H. MARSH, SECURITIES REGULATION 671 (5th ed. 1982) (footnote omitted). The omitted footnote is worth quoting in its entirety: "In reading some of the cases, one has the feeling that the complaint may have been drafted in advance with the name of the defendant left blank, to be filled in as the occasion may require." *Id.* at 671 n.1; *see also* R. GILSON, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 642 (1986) ("The single most common response to an unwanted offer is litigation."); Cohn, *Tender Offers and the Sale of Control: An Analogue to Determine the Validity of Target Management Defensive Measures,* 66 IOWA L. REV. 475, 487 (1981) ("Immediate initiation of litigation seeking a preliminary injunction against the tender offer proceeding has been almost a knee-jerk reaction in hostile takeover situations."); E. ARANOW & H. EINHORN, *supra* note 8, at 266 ("There are very few contested tender offers where the target will not consider legal action as a method of resisting the offeror's advances."); S. LORNE, *supra* note 8, at § 4.05[3][b][i] ("Invariably, the first tactic to be employed by the subject company will be litigation. . . . [T]he very existence of hard-fought litigation may be thought to have some *in terrorem* value . . . ."); H. KRIPKE, THE SEC AND CORPORATE DISCLOSURE: REGULATION IN SEARCH OF A PURPOSE 270 (1979) (describing tender offer litigation as "necessarily a game, a series of litigating tactics with teams ready to fly into action at the first sign of a tender offer, . . . [where] the concept of law as a system of justice is totally irrelevant").

17. For this study, I began by compiling from the *SEC News Digest* a list of all Schedules 14D-1 filed between January 1, 1982, and June 1, 1985. The result was a collection of 364 tender offers. I then conducted a search of the NEXIS database for stories on each tender offer. (The NEXIS service, owned and operated by Mead Data Central, provides on-line access to 137 newspaper, magazine, wire service, and newsletter files.) I was able to locate stories for 263 of the tender offers. The stories revealed that target management favored the bid in 138 cases and announced its opposition in 95; in 30 cases management's position was neutral or unclear. I further determined from the stories that target managers filed a lawsuit against the bidder in 60 of the 95 cases in which management opposed the bid. (Note that I characterized management's position by reference to its *initial* response to the takeover bid. Thus, takeover attempts in which the target managers *ultimately* acceded to the initial or a subsequent bidder were defined as hostile if target management's first response was opposition.) The results of this study are on file with the *Michigan Law Review.*

Note that my study necessarily omitted tender offers for which no Schedule 14D-1 was filed (*i.e.,* tender offers for shares not registered under the 1934 Act. *See* Securities Exchange Act of 1934, § 14(d)(1), 15 U.S.C. § 78n(d)(1) (1982)). In addition, tender offers not reported in NEXIS files were excluded. Since takeover contests may be more newsworthy than uncontested acquisitions, my sample may reflect a selection bias in favor of hostile bids. On the other hand, I did find more accounts of friendly than unfriendly bids. My study, moreover, focused on hostile bids, so any selection bias in favor of such cases seems unimportant.

It is also worth noting that my sample consists of very recent bids. This is significant in view of the assertion by some takeover specialists that the incidence of target litigation has declined dramatically in the last few years. *See* note 31 *infra.*

cluding those that are unopposed by target management.[18] If, as my study suggests, roughly thirty-six percent of all tender offers are contested by target management,[19] Jarrell's data indicate that resistant target managers almost always sue.[20]

Given the strategic advice that takeover specialists commonly offer[21] and the complexity of the claims typically asserted in such actions,[22] it is difficult to resist the conclusion that targets sue bidders almost reflexively as a defensive response against unwanted offers.[23]

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18. *See* Jarrell, *supra* note 4, at 160-61.

19. A recent study by the SEC's Office of the Chief Economist reports that initially negotiated bids accounted for 56% of all tender offers made from 1981 through 1984. *See* OFFICE OF THE CHIEF ECONOMIST, THE ECONOMICS OF ANY-OR-ALL, PARTIAL, AND TWO-TIER TENDER OFFERS, table 1b (Apr. 19, 1985) [hereinafter STUDY OF THE CHIEF ECONOMIST]. According to the SEC's data, at most 44% of all tender offers are hostile; if we assume that target managers are neutral in at least some cases (my study suggests that management's position is neutral or unclear in about 11% of all cases), then the SEC's data and mine are quite consistent.

20. Indeed, in explaining his study, Jarrell has stated that he "treat[ed] litigation as *defining* hostility; if target managers don't sue, then they are *not* hostile to my way of thinking." Letter from Gregg A. Jarrell (Mar. 21, 1986) (emphasis in original) (on file with the *Michigan Law Review*). Of course, Jarrell's methodology makes impossible any meaningful extrapolation of litigation rates from his data; by *defining* hostility as synonymous with litigation, he obviously assured a litigation rate of 100% in hostile takeover cases. My data suggest that, at least since 1981, resistant target managers do not *always* litigate, although they apparently still do so with great frequency (*i.e.*, 63% of the time).

21. *See* notes 12-16 *supra* and accompanying text. *But see* note 23 *infra*.

22. *See* note 8 *supra* & notes 36-40 *infra* and accompanying text.

23. This may be changing, as target managers resort with increasing frequency to so-called structural defenses such as recapitalizations, stock repurchases, and asset sales. *See* Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 6-7, 43-44, 52-60 (1986); *see also* note 31 *infra* (noting the observation of some takeover lawyers that targets are relying less on litigation as a defensive measure).

It is also worth noting that some specialists are careful to counsel target managers who do sue to assert only meritorious, bona fide claims. While these specialists recognize the tactical value of litigation, they clearly reject the use of litigation for *purely* tactical reasons. *See, e.g.*, 1 A. FLEISCHER, *supra* note 8, at 299 & n.22; Reuben & Elden, *supra* note 13, at 437-38.

Lawyers, of course, are forbidden from filing groundless or tactically motivated lawsuits. For example, rule 11 of the Federal Rules of Civil Procedure provides:

> Every pleading, motion and other paper of a party represented by an attorney shall be signed by at least one attorney of record in his individual name . . . . The signature of an attorney . . . constitutes a certificate by him that he has read the pleading, motion, or other paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. . . . If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it . . . an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee.

FED. R. CIV. P. 11. *See generally* Note, *The Dynamics of Rule 11: Preventing Frivolous Litigation by Demanding Professional Responsibility*, 61 N.Y.U. L. REV. 300 (1986) [hereinafter Note, *Dynamics of Rule 11*]. Lawyers are similarly constrained by professional ethical obligations. *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-109, DR 7-102(A)(1), (2), EC 2-30, 7-4 (1980); MODEL RULES OF PROFESSIONAL CONDUCT Rules 1.16(a)(1), 3.1, 3.2, 4.4 (1983); *see also* Note, *A Lawyer's Duty to Reject Groundless Litigation*, 26 WAYNE L. REV. 1561 (1980).

More broadly, lawyers who help target managers resist takeover bids may face a serious

Judicial reactions to target lawsuits suggest that courts recognize the tactical nature of much anti-takeover litigation.[24] For example, in *D-Z Investment Co. v. Holloway*,[25] the Court referred expressly to the litigants' attempt "to use this court to further [their] objective[s]" in "a struggle . . . over the control of" the target company.[26] The court denied the target's motion for a preliminary injunction against the bidder, reasoning that "[m]anagement is simply trying to protect its entrenched position and, while its attackers must obey the securities laws, enforcement of those laws is, with rare exceptions, best left to the SEC or to the [target] stockholders . . . ."[27] Similarly, Judge Friendly has warned that "district judges must be vigilant against resort to the courts on trumped up or trivial grounds as a means for delaying and thereby defeating legitimate tender offers."[28] Plainly, judges are grow-

conflict of interest. Under both the *Model Code of Professional Responsibility* and the *Model Rules of Professional Conduct*, corporate counsel represents the corporate entity, rather than its directors, officers or shareholders. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-18 (1980); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(a) (1983). It is unclear whether these standards permit a lawyer to advise managers regarding tender offer defensive measures if it appears that the interests of the managers and their shareholders conflict. *See* note 35 *infra* and accompanying text (discussing target management's conflict of interest). This question, part of the larger problem of defining the obligations of corporate counsel, is remarkably difficult, and beyond the scope of this Article. It is interesting, however, that one noted commentator believes that "[t]he discrepancy between [reality] and the standards set forth by the Model Rules of Professional Responsibility [and their predecessors] is substantial." R. GILSON, *supra* note 16, at 650. *See generally* Schuchman, *Relations Between Lawyers*, in ETHICS AND ADVOCACY 73 (American Trial Lawyers Foundation 1978); Cary, *Professional Responsibility in the Practice of Corporation Law: The Murky Divide Between Right and Wrong*, in PROFESSIONAL RESPONSIBILITY OF THE LAWYER 27, 29-30 (N. Galston ed. 1977); G. HAZARD, ETHICS IN THE PRACTICE OF LAW 47-57 (1978); Rotunda, *Law, Lawyers and Managers*, in THE ETHICS OF CORPORATE CONDUCT 127, 133-34 (C. Walton ed. 1977); Patterson, *A Preliminary Rationalization of the Law of Legal Ethics*, 57 N.C. L. REV. 519, 522 (1979); Van Dusen, *Who Is Counsel's Corporate Client*, 31 BUS. LAW. at 474 (1975); Pierce, *The Code of Professional Responsibility in the Corporate World: An Abdication of Professional Self-Regulation*, 6 U. MICH. J.L. REF. 350, 356-67 (1973); Note, *Developments in the Law — Conflicts of Interest in the Legal Profession*, 94 HARV. L. REV. 1244, 1334-43 (1981).

24. *See generally* 1 A. FLEISCHER, *supra* note 8, at 298-99.

25. [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,771 (S.D.N.Y. 1974).

26. [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 96,562.

27. [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 96,562.

28. Electronic Specialty Co. v. International Control Corp., 409 F.2d 937, 947 (2d Cir. 1969). Judge Friendly's concern with the tactical use of litigation is evident throughout his opinion. For example, following the statement quoted above, he noted that "Congress intended [the Williams Act] to assure basic honesty and fair dealing, not to impose an unrealistic requirement of laboratory conditions that might make the new statute a potent tool for incumbent management to protect its own interests against the desires and welfare of the stockholders." 409 F.2d at 948.

The warnings in *Electronic Specialty* that target managers may resort to litigation for purely tactical reasons have been quoted approvingly by many courts, indicating increasing judicial awareness of this phenomenon. *See, e.g.*, Seaboard World Airlines, Inc. v. Tiger Intl., Inc., 600 F.2d 355, 363 (2d Cir. 1979); Prudent Real Estate Trust v. Johncamp Realty, Inc., 599 F.2d 1140, 1148 (2d Cir. 1979); Missouri Portland Cement Co. v. H.K. Porter Co., 535 F.2d 388, 397 (8th Cir. 1976); Susquehanna Corp. v. Pan Am. Sulphur Co., 423 F.2d 1075, 1085 (5th Cir. 1970); American Gen. Corp. v. NLT Corp., [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶

ing less patient with this defensive tactic; they are wary of frivolous claims and critical of target management attempts to wage control contests in the courts.[29]

98,808 at 94,142 (S.D. Tex. July 1, 1982); Marshall Field & Co. v. Icahn, 537 F. Supp. 413, 416 (S.D.N.Y. 1982); Grumman Corp. v. LTV Corp., 527 F. Supp. 86, 99 (E.D.N.Y.), *affd.*, 665 F.2d 10 (2d Cir. 1981); Connecticut Gen. Mortgage & Realty Inv. v. Siddall, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,409 at 92,448 (D. Mass. July 14, 1981); Crouse-Hinds Co. v. InterNorth, Inc., 518 F. Supp. 416, 456 (N.D.N.Y. 1980); Raybestos-Manhattan, Inc. v. Hi-Shear Indus., 503 F. Supp. 1122, 1126, 1136 (E.D.N.Y. 1980); Pargas, Inc. v. Empire Gas Corp., 423 F. Supp. 199, 207-08, 212 (D. Md.), *affd.*, 546 F.2d 25 (4th Cir. 1976); Alaska Interstate Co. v. McMillan, 402 F. Supp. 532, 540 (D. Del. 1975); Spielman v. General Host Corp., 402 F. Supp. 190, 206 (S.D.N.Y. 1975), *affd.*, 538 F.2d 39 (2d Cir. 1976); Commonwealth Oil Refining Co. v. Tesoro Petroleum Corp., 394 F. Supp. 267, 273-74 (S.D.N.Y. 1975); Broder v. Dane, 384 F. Supp. 1312, 1319 (S.D.N.Y. 1974); Metro-Goldwyn-Mayer Inc. v. Transamerica Corp., 303 F. Supp. 1344, 1348 (S.D.N.Y. 1969).

Several years after the decision in *Electronic Specialty,* Judge Friendly was still troubled by the use of litigation in takeover contests:

> This appeal illustrates the growing practice of companies that have become the target of tender offers to seek shelter under § 7 of the Clayton Act. . . . Drawing Excalibur from a scabbard where it would doubtless have remained sheathed in the face of a friendly [tender] offer, the target company typically hopes to obtain a temporary injunction which may frustrate the acquisition since the offering company may well decline the expensive gambit of a trial or, if it persists, the long lapse of time could so change conditions that the offer will fail even if, after a full trial and appeal, it should be determined that no antitrust violation has been shown.

Missouri Portland Cement Co. v. Cargill, Inc., 498 F.2d 851, 854 (2d Cir.), *cert. denied,* 419 U.S. 883 (1974). In the same case he also observed, with respect to the Williams Act claim that target management had asserted, that "[t]arget companies must not be provided the opportunity to use [disclosure provisions] as a tool for dilatory litigation." 498 F.2d at 872.

29. In addition to the cases cited in note 28 *supra,* see, for example, Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 60 (2d Cir. 1985) ("Although we should not hesitate to enforce the [Williams] Act's disclosure provisions through appropriate relief, we must also guard against improvident or precipitous use of remedies that may have the effect of favoring one side or the other in a takeover battle when allegations of violation of the Act, often made in the heat of the contest, may not be substantiated. In this context the preliminary injunction, which is one of the most drastic tools in the arsenal of judicial remedies, must be used with great care, lest the forces of the free market place, which in the end should determine the merits of takeover disputes, are nullified.") (citation omitted); Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 269 (2d Cir. 1984) ("Developments in corporate control contests often proceed swiftly, and timing may have a crucial impact on the outcome. . . . [T]he courts themselves are too often drawn into the fray. . . . [I]t is not for us to make the policy choices that will determine whether this style of corporate warfare will escalate or diminish."); Gearhart Indus. v. Smith Intl., 741 F.2d 707, 715 (5th Cir. 1984) (refusing to grant target preliminary injunction in part because of reluctance "to provide a weapon for management to discourage takeover bids or prevent large accumulations of stock which would create the potential for such attempts") (quoting Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 58 (1975)); Liberty Natl. Ins. Holding Co. v. Charter Co., 734 F.2d 545, 566 (11th Cir. 1984) ("To permit the [target to sue the bidder] simply because [the bidder] made a false filing would tip the balance towards [target] management, thereby injuring the existing investors. . . . The threat of this sort of litigation might remove from the field a player whose self-interest is to monitor management, and who is poised to mount a proxy fight or a tender offer."); Chromalloy Am. Corp. v. Sun Chem. Corp., 611 F.2d 240, 249 (8th Cir. 1979) ("The disclosure requirements established by Congress are not intended to provide a weapon for current management to discourage bids or prevent large accumulations of stock."); Corenco Corp. v. Schiavone & Sons, Inc., 488 F.2d 207, 209-10 (2d Cir. 1973) ("A familiar defensive tactic increasingly used by target companies to delay or thwart a take-over bid . . . has been the institution of a lawsuit against the offeror charging violations of the federal antitrust laws or non-disclosure of material information in violation of the Williams Act.") (citation omitted); Butler Aviation Intl. v. Comprehensive Designers, Inc., 425 F.2d 842, 845 (2d Cir. 1970) ("While courts should rigorously enforce the policy of honesty and fair dealing prescribed by federal securities legislation, they

Of course, it is tempting to conclude in light of this increasingly

must guard against the risk that, at the instance of incumbent management, they may be frustrating informed shareholders from doing what the latter want."); Seilon, Inc. v. Lamb, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,448, at 96,549-51 (N.D. Ohio 1983) ("[E]xtending standing to the [target] brings with it grave risks to the shareholders and their interests. By allowing management to sue in the corporation's name, some delay in the ultimate resolution of the dispute between incumbents and challengers will always occur. . . . [D]elay favors embattled management. Moreover, and perhaps more importantly, management can use the corporation's assets as its armory against the takeover campaign. In many, if not most instances, this opportunity will be exploited for the benefit of management, and to the detriment of the shareholder's equity and investment. . . . Any attempt to expand [Williams Act] litigation must be strenuously resisted, else the judiciary find itself unwittingly furthering the destruction of vital shareholder interests."); Equity Oil Co. v. Consolidated Oil & Gas, 596 F. Supp. 507, 511, 514 (D. Utah 1983) ("A private cause of action [under section 13(d) of the Securities Exchange Act of 1934] for injunctive relief in the hands of [target] management would tip the balance in its favor, providing a powerful weapon for delay and perhaps defeat of a takeover attempt. . . . The [Williams Act] was designed to maintain neutrality in takeover attempts [and therefore] does not support [such] an implied right of action. . . . As soon as a Schedule 13D is filed, entrenched management can use a suit for an injunction, with voluminous discovery requests, for its delay value to defeat any takeover attempt, *regardless of the merits of the case.*") (footnote omitted, emphasis added); Marshall Field & Co. v. Icahn, 537 F. Supp. 413, 416 (S.D.N.Y. 1982) ("[L]itigation can be misused by management for self-perpetuation in a manner which is contrary to the interest and welfare of their stockholders."); Kaufman & Broad, Inc. v. Belzberg, 522 F. Supp. 35, 45 (S.D.N.Y. 1981) ("The question arises as to whether the mere assertion that a defendant's actual undisclosed intent is to acquire control is sufficient to state a claim, mindful of the Supreme Court's admonition that Section 13(d) was not designed to provide a weapon for management to prevent large accumulations of stock, and of the potential for abusive and harassing litigation that might be instigated against every investor that acquires sufficient shares and files a Schedule 13D.") (citation omitted); Standard Metals Corp. v. Tomlin, 503 F. Supp. 586, 603 (S.D.N.Y. 1980) ("To grant a preliminary injunction under [these] circumstances would unfairly provide [target] management with a weapon to discourage take-over bids, contrary to the purpose of Section 13(d)."); Gateway Indus. v. Agency Rent A Car, Inc., 495 F. Supp. 92, 101 (N.D. Ill. 1980) ("[P]ermitting [target] corporations to maintain [section 13(d)] actions well might give them a competitive advantage vis-a-vis takeover groups and thereby destroy the neutrality the Williams Act sought to achieve."); Treadway Cos. v. Care Corp., 490 F. Supp. 660, 664, 666 (S.D.N.Y.), *modified,* 638 F.2d 357 (2d Cir. 1980) ("The [Williams Act] was not intended to be used as a device by which incumbent management defends itself against a takeover bid. . . . [T]he Court does not believe that [target management] is the most appropriate party to maintain this suit in view of its interest (be it paramount or not) in retaining corporate control, an interest that does not necessarily coincide with the interests of the shareholders."); Chromalloy Am. Corp. v. Sun Chem. Corp., 483 F. Supp. 116, 119 (E.D. Mo. 1980) ("Plaintiff's allegations concerning environmental disclosure, with the attendant extensive discovery, seem little more than a dilatory tactic."); S-G Sec., Inc. v. Fuqua Inv. Co., 466 F. Supp. 1114, 1128 (D. Mass. 1978) ("[T]arget companies must not be provided the opportunity to use the [Williams Act disclosure provisions] as a tool for dilatory litigation.") (quoting Susquehanna Corp. v. Pan Am. Sulphur Co., 423 F.2d 1075, 1086 (5th Cir. 1970)); Otis Elevator Co. v. United Technologies Corp., 405 F. Supp. 960, 965 (S.D.N.Y. 1975) (quoting Butler Aviation Intl., Inc. v. Comprehensive Designers, Inc., 425 F.2d 842, 845 (2d Cir. 1970), *quoted supra*); Jewelcor, Inc. v. Pearlman, 397 F. Supp. 221, 225, 238 (S.D.N.Y. 1975) ("Federal courts . . . have become a common arena in which tender offer battles are waged. . . . Target companies must not be provided the opportunity to use [Williams Act disclosure provisions] as a tool for dilatory litigation."); Texasgulf, Inc. v. Canada Dev. Corp., 366 F. Supp. 374, 430-31 (S.D. Tex. 1973) ("We have delayed too long. The temporary restraining order should have been dissolved weeks ago. Texasgulf has bought itself more time than was needed. It is now time for the shareholders to decide in the democratic marketplace if they want to tender their shares . . . and for those who have already tendered them to decide if, in light of this opinion, they wish to withdraw their tenders."); Nicholson File Co. v. H.K. Porter Co., 341 F. Supp. 508, 520 (D.R.I. 1972) ("The intent of § 13(d) was to protect shareholders, not to give management a tool to fight off unwelcome tender offers."), *affd.,* 482 F.2d 421 (1st Cir. 1973); *see also* San Francisco Real Estate Investors v. Real Estate Inv. Trust of common judicial attitude that the courts can (and do) view target lawsuits with appropriate suspicion and that further regulation of this defensive response is unnecessary. Proponents of this view would cite judicial disapprovals of target litigation not as evidence of a problem in need of a solution,[30] but rather as proof that the courts themselves are effectively checking attempts to use litigation improperly as a weapon in control contests.[31] To put this somewhat differently, since a grant of relief presupposes that the plaintiff's claim has merit, a decision that relief is warranted (and, conversely, the courts' willingness to deny relief where it is not)[32] obviates the danger that target managers may be using litigation inappropriately to entrench themselves in office.

This argument, however, confuses the meritoriousness of a legal claim with the propriety of permitting its assertion by target managers;[33] even if such a claim is, in one sense, properly brought, it may not be proper for target management to bring it. Moreover, even unsuccessful litigation may hamper a value-increasing takeover or impose otherwise avoidable costs on takeover contestants and society. Target litigation, in short, poses dangers that arise principally from the conflict of interest that potentially afflicts target managers in a control contest. In Part II, I discuss those dangers and suggest that, absent other safeguards, they are not adequately mitigated by a judicial determination of meritoriousness.

II. Target Management's Conflict of Interest and the Dangers of Target Litigation

Managers may oppose takeover attempts for many reasons, including a good faith belief that such opposition can result in a better deal for their shareholders.[34] It would be unfair and inaccurate to conclude that managers oppose tender offers *only* to retain their control

Am., 701 F.2d 1000, 1002-03 (1st Cir. 1983); Dan River, Inc. v. Icahn, 701 F.2d 278, 283-84, 286-87 (4th Cir. 1983).

30. *Cf.* notes 24-29 *supra* and accompanying text.

31. *See, e.g.,* 1 A. Fleischer, *supra* note 8, at 298 (arguing that "[a]t this time, courts appear generally unsympathetic — they are skeptical about target claims and reluctant to obstruct premium offers and free market dynamics") (footnotes omitted); Hertzberg, *Takeover Targets Find Loading Up on Debt Can Fend Off Raiders,* Wall St. J., Sept. 10, 1985, at 1, col. 6 (Midwest ed.) (arguing that "[t]he period of the litigation defense is gone" (quoting Martin Lipton) and that "[t]he courts will intervene on occasion, but there's much more sparing use of their power" (quoting Arthur Fleischer, Jr.)).

32. *See* notes 28 & 29 *supra.*

33. Moreover, it implies, perhaps incorrectly, *see* note 43 *infra,* that a grant of *preliminary* relief confirms a claim's merit.

34. *See* notes 77-85 *infra* and accompanying text.

over a target's assets. On the other hand, target managers can suffer serious losses in takeovers; relinquishing control can involve an obvious loss of wealth and stature, often through forfeiture of firm-specific human capital.[35] Ignoring the self-interested incentives of managers to fight control bids would therefore be unrealistic.

In view of target management's potential conflict of interest, target lawsuits pose two distinctive risks. First, litigation has a special tactical value for target managers concerned with protecting their own positions. As a result, when faced with a hostile tender offer, conflicted target managers may be tempted, to an unusual degree, to manufacture a legal claim where there is in fact no injury. Second, litigation frequently confounds hostile bidders and helps preserve the independence of the target firm. Empirical studies demonstrate that this result often harms target shareholders and perhaps the economy generally by impeding the flow of corporate resources to their highest-valued uses.

I discuss these points separately in this Part, concluding that target litigation should be subjected to rules designed to temper target management's conflict of interest. Such rules, I suggest in Part III, would preserve the ability of target managers to pursue bona fide legal claims while diminishing the risks that currently inhere in target litigation.

A. *The Tactical Value of Target Litigation and the Risk of Frivolous Claims*

A variety of tactical considerations can lead target managers to file lawsuits against hostile bidders with little regard for the underlying merits of such suits. Occasionally, for example, managers hope that a lawsuit will actually result in a permanent or temporary injunction against the bid and thus defeat an unwanted takeover attempt.[36]

35. *See, e.g.*, Jensen & Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5, 31 (1983). In other words, managers may have training and skills that are peculiarly suited to the target firm. If these managers lose their jobs, they may therefore be unable to secure new positions at the same levels of prestige and compensation. *See also* Easterbrook & Fischel, *supra* note 2, at 1197-98 (discussing target management's conflict of interest). Similarly, as John Coffee notes in a slightly different context, "[m]anagers are inherently overinvested in the firm they serve.... [T]he manager... is [thus] economically wedded to his firm." Coffee, *supra* note 23, at 17, 19. Coffee's thesis — that asymmetric attitudes toward risk produce "a deep internal strain" between shareholders and managers, *id.* at 13, suggests a more pervasive conflict of interest than the one on which I focus. Thus, Coffee's argument implies that management's greater aversion to risk affects *all* management decisions, including the decision whether (and how) to oppose a takeover bid. *See id.* at 16-24, 60-67. Coffee proposes a "policy of premium sharing," *id.* at 9, 14, that would produce a more equitable division of takeover gains between target shareholders and their managers. Arguably, such a policy would abate target management's conflict of interest and thus reduce its urge to resist takeover attempts. I discuss Coffee's proposal below. *See* notes 187-92 *infra* and accompanying text.

36. *See generally* 1 A. FLEISCHER, *supra* note 8, at 257-64; 1 M. LIPTON & E. STEINBERGER, *supra* note 8, at § 6.09[1]; E. ARANOW & H. EINHORN, *supra* note 8, at 266; S. LORNE, *supra*

Thus, target managers sometimes sue bidders under section 7 of the Clayton Act,[37] claiming that the proposed takeover would substantially lessen competition.[38] Similarly, targets may bring injunctive actions asserting violations of other substantive legal requirements, such as federal margin regulations[39] or special provisions restricting control changes.[40] In these cases, the plaintiffs hope that the lawsuit will be a

note 8, at § 4.05[3][6][i]; Cherno & Sussman, *Tender-Offer Litigation*, LITIGATION, Winter 1984, at 41, 44.

37. 15 U.S.C. § 18 (1982).

38. *See, e.g.*, Marathon Oil Co. v. Mobil Corp., 669 F.2d 378 (6th Cir. 1981), *cert. denied*, 455 U.S. 982 (1982); Grumman Corp. v. LTV Corp., 665 F.2d 10, 11 (2d Cir. 1981); Buffalo Forge Co. v. Ampco-Pittsburgh Corp., 638 F.2d 568 (2d Cir. 1981); Harnischfeger Corp. v. Paccar, Inc., 624 F.2d 1103 (7th Cir.) (decision without published opinion), *affg.* 474 F. Supp. 1151 (E.D. Wis. 1979); Pargas, Inc. v. Empire Gas Corp., 546 F.2d 25 (4th Cir.) (per curiam), *affg.* 423 F. Supp. 199 (D. Md. 1976); Missouri Portland Cement Co. v. Cargill, Inc., 498 F.2d 851, 854 (2d Cir.), *cert. denied*, 419 U.S. 883 (1974).

Target managers sometimes assert claims under other antitrust provisions, such as section 8 of the Clayton Act, 15 U.S.C. § 19 (1982) (barring interlocking directorates), *see, e.g.*, Crouse-Hinds Co. v. InterNorth, Inc., 518 F. Supp. 416, 448 n.12 (N.D.N.Y. 1980), or section 1 of the Sherman Act, 15 U.S.C. § 1 (1982) (barring agreements in restraint of trade), *see, e.g.*, Emhart Corp. v. USM Corp., 527 F.2d 177 (1st Cir. 1975), but Clayton Act section 7 claims are far more common.

For a discussion of target managers' standing to assert antitrust claims, see Easterbrook & Fischel, *supra* note 15.

39. *See, e.g.*, Pabst Brewing Co. v. Jacobs, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,042 (D. Minn. 1982); Pargas, Inc. v. Empire Gas Co., 423 F. Supp. 199 (D. Md.), *affd. per curiam*, 546 F.2d 25 (4th Cir. 1976). The federal margin regulations, adopted by the Board of Governors of the Federal Reserve System pursuant to section 7 of the Securities Exchange Act of 1934, 15 U.S.C. § 78g (1982), limit the use of debt for the purchase of securities. *See* 12 C.F.R. §§ 207, 220, 221, 224 (1986) (respectively, Regulations G, T, U, and X).

Those courts of appeals that have considered the issue have refused to recognize implied private rights of action for violations of the margin rules. *See* Bennett v. United States Trust Co., 770 F.2d 308 (2d Cir. 1985), *cert. denied*, 106 S. Ct. 800 (1986); Bassler v. Central Natl. Bank, 715 F.2d 308 (7th Cir. 1983); Walck v. American Stock Exch., 687 F.2d 778 (3d Cir. 1982), *cert. denied*, 461 U.S. 942 (1983); Gilman v. Federal Deposit Ins. Corp., 660 F.2d 688 (6th Cir. 1981); Gutter v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 644 F.2d 1194 (6th Cir. 1981), *cert. denied*, 455 U.S. 909 (1982); Stern v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 603 F.2d 1073 (4th Cir. 1979); Utah State Univ. v. Bear, Stearns & Co., 549 F.2d 164 (10th Cir.), *cert. denied*, 434 U.S. 890 (1977). Moreover, in 1982 the Board of Governors adopted amendments to the margin rules that lessened their impact on corporate takeovers. *See* 12 C.F.R. §§ 220.7(a)(1), 221.1, 207.2(1) (1986); 1 A. FLEISCHER, *supra* note 8, at 304-05. Accordingly, although targets still sometimes assert *disclosure* violations based on the failure to reveal margin violations, *see, e.g.*, Pargas, Inc. v. Empire Gas Corp., 423 F. Supp. 199 (D. Md.), *affd. per curiam*, 546 F.2d 25 (4th Cir. 1976); Pabst Brewing Co. v. Jacobs, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,042 (D. Minn. 1982); Pabst Brewing Co. v. Kalmanovitz, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,873 (D. Del. 1982); Alaska Interstate Co. v. McMillian, 402 F. Supp. 532 (D. Del. 1975), margin claims have become less useful to target managers.

40. Some states, for example, bar transfers of control involving state banks or insurance companies without prior approval by state authorities. *See, e.g.*, CAL. FIN. CODE § 11706 (Deering 1978); MO. REV. STAT. § 382.040 (Supp. 1986); N.Y. BANKING LAW § 142 (McKinney 1971 & Supp. 1986); OR. REV. STAT. § 722.072 (1985). Similarly, in certain regulated industries federal provisions require administrative agency approval of control changes. These types of provisions apply, for instance, to banks and bank holding companies, *see* Bank Holding Company Act § 3, 12 U.S.C. § 1842 (1982); 12 U.S.C. §§ 1817(j), 1828(c); County Natl. Bancorporation v. Board of Governors, 654 F.2d 1253 (8th Cir. 1981); Marshall & Ilsley Corp. v. Heimann, 652 F.2d 685 (7th Cir. 1981), *cert. denied*, 455 U.S. 981 (1982), airlines, *see* Federal Aviation Act § 408, 49 U.S.C. § 1378 (1982), broadcasting companies, *see* Federal Communications Act §§ 221, 310, 47

"show-stopper" — a case in which the court finds sufficient evidence of illegality to warrant at least a preliminary injunction against the offeror. Issuance of even a preliminary injunction often effectively kills a hostile tender offer, for it postpones indefinitely the bidder's execution of the offer;[41] only the rarest of bidders would keep an offer open under such circumstances, even if it were willing to incur the considerable expense of a trial.[42]

Of course, in order to convince the court to issue a preliminary injunction, target management must go a long way toward proving illegal conduct by the bidder. Thus, although the standard may vary from one court to another, a plaintiff seeking a preliminary injunction generally must establish (1) a likelihood of success on the merits *and* (2) the inadequacy of a damage remedy for the alleged wrong (*i.e.*, that plaintiff will suffer irreparable harm if the injunction is not granted).[43]

U.S.C. §§ 221, 310 (1982); United States v. Radio Corp. of America, 358 U.S, 334 (1959); General Host Corp. v. Triumph American, Inc., 359 F. Supp. 749 (S.D.N.Y. 1973), interstate railroads and motor carriers, *see* Interstate Commerce Act §§ 5, 6, 7, 11, 14, 24 Stat. 379, 380-83 (1887) (current version at 49 U.S.C. §§ 11341, 11343-51 (1982)); United States v. ICC, 396 U.S. 491 (1970); Southern Pac. Transp. Co. v. ICC, 736 F.2d 708 (D.C. Cir. 1984), *cert. denied,* 469 U.S. 1208 (1985); Water Transp. Assn. v. ICC, 715 F.2d 581 (D.C. Cir. 1983), *cert. denied,* 465 U.S. 1006 (1984), and federal savings and loan associations, *see* 12 U.S.C. §§ 1730(q), 1730a(e) (1982); Kaneb Servs. v. Federal Sav. & Loan Ins. Corp., 650 F.2d 78 (5th Cir. 1981); Fidelity Fin. Corp. v. Federal Sav. & Loan Ins. Corp., 359 F. Supp. 324 (N.D. Cal. 1973).

41. This is not true, however, where the grant of preliminary injunctive relief is based on illegal conduct that is readily curable, such as violations of certain disclosure requirements. *See, e.g.,* Treadway Cos. v. Care Corp., 638 F.2d 357 (2d Cir. 1980); Condec Corp. v. Farley, 573 F. Supp. 1382 (S.D.N.Y. 1983); Saunders Leasing Sys. v. Societe Holding Gray D'Albion S.A., 507 F. Supp. 627 (N.D. Ala. 1981); Kirsch Co. v. Bliss & Laughlin Indus., 495 F. Supp. 488 (W.D. Mich. 1980). In such cases, the bidder can often remedy the disclosure problem and proceed with the offer without much (if any) delay beyond the time periods prescribed by the federal tender offer rules. *See, e.g.,* Pacific Realty Trust v. APC Invs., Inc., 685 F.2d 1083 (9th Cir. 1982); Chromalloy Am. Corp. v. Sun Chem. Corp., 611 F.2d 240 (8th Cir. 1979). *But see* Spinner Corp. v. Princeville Dev. Corp., [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,058 (D. Haw. 1986) (granting preliminary injunction due to inadequacy of corrective disclosure); MacFadden Holdings, Inc. v. JB Acquisition Corp. [1986-1987 Transfer Binder] Fed. Sec. L. Rep. ¶ 92,856, at 94,168-69 (S.D.N.Y.) (finding corrective disclosure and withdrawal inadequate in case of "deliberate" and "blatant" misrepresentations), *revd.,* [1986-1987 Transfer Binder] Fed. Sec. L. Rep. ¶ 92,939 (2d Cir. 1986) (finding tender offer materials not misleading).

42. *See, e.g.,* Missouri Portland Cement Co. v. Cargill, Inc., 498 F.2d 851, 854 (2d Cir.), *cert. denied,* 419 U.S. 883 (1974) (Friendly, J.).

43. *See, e.g.,* Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 57 (1975); E.H.I. of Fla., Inc. v. Insurance Co. of N. Am., 652 F.2d 310, 312-13 (3d Cir. 1981); Los Angeles Memorial Coliseum Commn. v. National Football League, 634 F.2d 1197, 1200-01 (9th Cir. 1980); Mason County Medical Assn. v. Knebel, 563 F.2d 256, 261 (6th Cir. 1977); Canal Auth. v. Callaway, 489 F.2d 567, 572-73 (5th Cir. 1974); Bath Indus. v. Blot, 427 F.2d 97 (7th Cir. 1970). In addition, courts usually consider how their decision whether to grant or refuse a preliminary injunction will affect other interests, including the general public interest. *See* authorities cited *supra,* this footnote.

Some have argued that this standard is too restrictive. Professor Hammond, for example, suggests that a lower threshold may be appropriate where, practically speaking, the failure to grant a preliminary injunction may render later judicial proceedings ineffectual. Hammond, *Interlocutory Injunctions: Time for a New Model?,* 30 U. TORONTO L.J. 240 (1980). A few courts, perhaps in response to this claim, have fashioned a more liberal standard. In the Second Circuit, for example, a plaintiff seeking a preliminary injunction must show irreparable harm and *either*

Show-stoppers are therefore rare where target managers are acting *purely* tactically, with *no* regard for the merits of their legal claims.

A more realistic goal of target litigation is to *delay* the tender offer beyond the usual minimum period of twenty business days.[44] Target managers may accomplish this goal by obtaining relief that has the effect of extending the offer. For example, a court may respond to alleged disclosure violations by ordering that the offer remain open for a certain period following full and complete disclosure by the bidder.[45] Alternatively, even where the target managers have little hope of obtaining a preliminary injunction against the bidder, they may be able to persuade the court to issue a temporary restraining order that effectively delays execution of the bid.[46]

Delay can significantly enhance management's efforts to resist a hostile bid. It affords managers more time to defeat the bid by implementing a variety of defensive measures[47] or, as a last resort, arranging

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(1) a likelihood of success on the merits *or* (2) sufficiently serious questions going to the merits to make them a fair ground for litigation *and* a balance of hardships tipping decidedly in plaintiff's favor. *See, e.g.*, Dallas Cowboy Cheerleaders, Inc. v. Pussycat Cinema, Ltd., 604 F.2d 200, 206-07 (2d Cir. 1979); Sonesta Intl. Hotels Corp. v. Wellington Assocs., 483 F.2d 247 (2d Cir. 1973); *see also* Dataphase Sys. v. C L Sys., 640 F.2d 109, 112-13 (8th Cir. 1981); Chromalloy Am. Corp. v. Sun Chem. Corp., 611 F.2d 240, 244 (8th Cir. 1979). But even this standard requires the movant, at the very least, to demonstrate fair ground for litigating the merits of its claim.

In any case, the traditional test and its variants may be inapt for takeover litigation, where litigants arguably seek preliminary injunctions "to speed a decision and obtain a final resolution before events outrun the litigation process." O. FISS & D. RENDLEMAN, INJUNCTIONS 367 (2d ed. 1984); *see* Leubsdorf, *The Standard for Preliminary Injunctions*, 91 HARV. L. REV. 525, 557 (1978) ("There can be a whole class of cases in which final hearings are unlikely . . . . Rather than try to predict how a fictional final hearing would apply a hypothetical final standard, courts should develop a standard for the single hearing that does occur."). Even a new standard, however, would leave the problem of tactically motivated target litigation unresolved if it failed to prevent the use of lawsuits to *delay* takeover bids. *See* notes 44-52 & 77-85 *infra* and accompanying text.

44. SEC Rule 14e-1, 17 C.F.R. § 240.14e-1 (1986).

45. *See, e.g.*, Kirsch Co. v. Bliss & Laughlin Indus., 495 F. Supp. 488 (W.D. Mich. 1980) (barring offeror from buying target's shares for 30 days following amendment of schedule 13D); *see also* Spencer Cos. v. Agency Rent-a-Car, Inc., 542 F. Supp. 237 (D. Mass. 1982) (restraining filer of false schedule 13D from voting acquired shares pending remedial measures); Financial Gen. Bankshares, Inc. v. Lance, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,403 (D.D.C. 1978) (barring defendants who had improperly failed to file a schedule 13D from buying more shares or soliciting proxies until they made a rescission offer to sellers).

46. *See, e.g.*, Scientific Computers, Inc. v. Edudata Corp., 599 F. Supp. 1092 (D. Minn.) (denying target's motion for preliminary injunction, following earlier grant of temporary restraining order, in view of finding that prior disclosure violations had been remedied), *affd. in part and dismissed in part*, 746 F.2d 429 (8th Cir. 1984). For discussions of the standards and procedures governing the issuance of temporary restraining orders, see O. FISS & D. RENDLEMAN, *supra* note 43, at 323-31; Nussbaum, *Temporary Restraining Orders and Preliminary Injunctions — The Federal Practice*, 26 SW. L.J. 265, 266-73 (1972).

47. *See* note 75 *infra* and accompanying text. Discussions of takeover defensive measures are legion. *See, e.g.*, P. DAVEY, DEFENSES AGAINST UNNEGOTIATED TENDER OFFERS (1977); Easterbrook & Fischel, *supra* note 2; Gilson, *supra* note 2; Hochman & Folger, *Deflecting Takeovers: Charter and By-Law Techniques*, 34 BUS. LAW. 537 (1979); Lynch & Steinberg, *The Legitimacy of Defensive Tactics in Tender Offers*, 64 CORNELL L. REV. 901 (1979); Steinbrink, *Manage-*

for a friendly merger with a "white knight."[48] It also increases the risk and expense of the offer,[49] which may cause the offeror to abandon its takeover attempt.[50] Thus, while delay does not always help managers preserve their control of the target firm,[51] it is perceived as a useful strategy in control contests.[52]

While most tactically motivated target lawsuits are filed with the hope of blocking or at least delaying the unwanted offer, there are other strategic considerations that motivate target managers to sue. First, suing underscores management's determination to defeat the bid. This may be psychologically rewarding to target managers, since it affords a tangible means by which they can demonstrate to themselves and other target employees that they intend to wage a fierce battle against the hostile bid.[53] More important, litigation also signals management's determination to the bidder, to the market in which the target's shares are traded, and, more particularly, to risk arbitrageurs.[54] Since target shareholders frequently try to avoid the risks

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ment's Response to the Takeover Attempt, 28 CASE W. RES. L. REV. 882 (1978); Note, *Lock-Up Options: Toward a State Law Standard,* 96 HARV. L. REV. 1068 (1983); Comment, *Antitakeover Maneuvers: Developments in Defensive Tactics and Target Actions for Injunctive Relief,* 35 SW. L.J. 617 (1981). *See generally* 1 A. FLEISCHER, *supra* note 8, at 291-387; 1 M. LIPTON & E. STEINBERGER, *supra* note 8, at §§ 6.01-6.09; S. LORNE, *supra* note 8, at § 4.05[3][b].

48. A "white knight" is a friendly party with which target management negotiates a merger. Obviously, a white knight merger is synonomous with successful resistance by target managers only if they are permitted to retain their positions in the successor or surviving firm.

In addition to affording target management time to locate and strike a deal with a white knight, litigation confirms the seriousness of management's intention to thwart the hostile bid; this can be tactically valuable as a means of maintaining the interest of a *potential* white knight with which the target managers have already begun discussions. *See* 1 A. FLEISCHER, *supra* note 8, at 300-01; Cherno & Sussman, *supra* note 36, at 44.

49. *See* note 75 *infra* and accompanying text; *see also* notes 78-79 *infra* and accompanying text (discussing likelihood of a bidding contest as a result of litigation).

50. *See, e.g.,* notes 77-85 *infra* and accompanying text (discussing empirical study of defeated takeover bids). Note also that, to the extent that a bidder is induced to withdraw rather than face a bidding contest for control of the target, litigation further stimulates the interest of potential white knights that management already may have contacted. *See* note 58 *infra.*

51. If the effect of delay is to provoke an auction for the target firm, the target usually loses its independence. *See* note 81 *infra* and accompanying text. Auctions, however, have a significant positive effect on target shareholder wealth. *See* notes 83-84 *infra* and accompanying text. It is this that leads Gregg Jarrell to assert that target litigation should be viewed as an attempt by managers to maximize the wealth of their shareholders. *See* Jarrell, *supra* note 4. I argue against that hypothesis below. *See* notes 92-143 *infra* and accompanying text.

52. *See, e.g.,* E. ARANOW & H. EINHORN, *supra* note 8, at 266; 1 A. FLEISCHER, *supra* note 8, at 300; 1 M. LIPTON & E. STEINBERGER, *supra* note 8, at § 6.05[5][a]; S. LORNE, *supra* note 8, at § 4.05[3][b][i]; Cherno & Sussman, *supra* note 36, at 44; Wachtell, *supra* note 12, at 1437; *see also* Jarrell, *supra* note 4, at 153; notes 77-82 *infra* and accompanying text.

53. *See, e.g.,* 1 M. LIPTON & E. STEINBERGER, *supra* note 8, at § 6.05[5][a]; Wachtell, *supra* note 12, at 1437-38. Occasionally, a vigorously asserted lawsuit may prove psychologically debilitating to the bidder, although that seems unlikely given that any reasonably sophisticated bidder will fully expect its offer to be met with litigation. *See, e.g.,* S. LORNE, *supra* note 8, at § 4.05[3][b][i].

54. For discussions of arbitrage activity in takeover contests, see E. ARANOW & H. EIN-

of the tender offer process by selling their shares to arbitrageurs,[55] the latter's actions often determine the outcome of control contests. Thus, it is in the interest of entrenched target management to convince arbitrageurs not to tender to a hostile bidder. Litigation can help accomplish that end by increasing the likelihood (or, perhaps more accurately, the arbitrageurs' *perception* of the likelihood) that the target managers will defeat or delay the offer or at least facilitate a bidding contest. Arbitrageurs who anticipate any of these outcomes will hold rather than tender — either to avoid tying up their shares in a delayed or unsuccessful offer, or in the expectation of a higher subsequent bid.[56]

Another tactical value of litigation is that it allows for wide-ranging discovery, which, in addition to being a source of expense and delay, provides target managers with a wealth of information regarding the bidder and the tender offer.[57] Much of this information may be useful for resisting the takeover attempt, even if it is only marginally relevant to target management's lawsuit.[58]

HORN, *supra* note 8, at 173-91; 1 M. LIPTON & E. STEINBERGER, *supra* note 8, at § 1.07[2]; Bradley & Rosenzweig, *supra* note 3, at 1393 n.60; Henry, *Activities of Arbitrageurs in Tender Offers*, 119 U. PA. L. REV. 466 (1971); Rubin, *Arbitrage*, 32 BUS. LAW. 1315 (1977).

55. *See* Bradley & Rosenzweig, *supra* note 3, at 1393 n.60 (discussing why target shareholders find it in their interest to sell to arbitrageurs and offering empirical evidence supporting this point).

56. On the latter possibility, see Bradley & Rosenzweig, *supra* note 3, at 1392-93 & n.60. A related goal of litigation may be to dissuade arbitrageurs from taking positions in the target's stock in the first place. As Herbert Wachtell has noted,

> one of the consequences of lawsuits in takeover situations is to chill the arbitrage. . . . [I]f the arbitrageurs go into the market and buy heavily in the stock, they in essence are going to be the owners of that company. They have a very short-term interest in their investment which means a 99 percent chance that that company is going to get owned by *someone* in the end — be it the original bidder or someone else — but it is not in all likelihood going to remain independent.
>
> So, one might be very interested, if one is representing the target company, in chilling the arbitrage, and chilling it fast, which means that a complaint has to get out very quickly. . . . [If] the arbitrageurs' counsel . . . say to the arbitrageurs, "I would be careful on this one. . . ." that heavy arbitrage buying may well not develop.

Wachtell, *supra* note 12, at 1437 (emphasis in original); *see also* 1 A. FLEISCHER, *supra* note 8, at 300; 1 M. LIPTON & E. STEINBERGER, *supra* note 8, § 6.05(5), at 6-61 to 6-62; Cherno & Sussman, *supra* note 36, at 44. To put this somewhat differently, management will have a better chance of defeating a bid if it can keep target stock from becoming concentrated in the hands of arbitrageurs, who, because of their sophistication and investment goals, are more likely to tender than "ordinary" target shareholders.

Note that, in a more general sense, litigation may be one way to generate publicity about the target's opposition to the bid, which could affect shareholder decisions whether to tender. *See, e.g.*, S. LORNE, *supra* note 8, § [3][b][i], at 4-99.

57. *See, e.g.*, Chromalloy Am. Corp. v. Sun Chem. Corp., 483 F. Supp. 116, 119 (E.D. Mo. 1980); S. LORNE, *supra* note 8, § 4.05[3][b][i]; Arthur, Kirby & Rein, *supra* note 14, at 10.

58. Some of this information may also be useful for attracting a potential white knight. *See* note 48 *supra* and accompanying text. For example, discovery can reveal the bidder's plans for value-increasing redeployment of the target's assets — information which may inspire the interest of another suitor. *Cf.* Gilson, *supra* note 2, at 865-67 (arguing that target managers should be permitted to engage in defensive tactics that reveal information to potential competing bidders).

Finally, target managers can offer to settle existing litigation as a concession in negotiations with the bidder for more favorable merger terms. Admittedly, this tactical use of litigation hardly aids in resisting an ultimate takeover,[59] but it does suggest yet another reason why management may sue for largely strategic purposes.[60]

In sum, resistant, self-interested target managers have powerful tactical incentives to sue hostile bidders, *whether or not* their action represents good-faith pursuit of a genuine legal claim. As a consequence, the risk that such managers will assert frivolous claims against bidders seems peculiarly great, especially when one recalls the apparent eagerness of some advisers to urge the commencement of litigation as an "automatic" response to an unwanted bid.[61] If so, heightened concern regarding the meritoriousness of target suits clearly seems appropriate.

More important, the likelihood that a target lawsuit will be brought for tactical reasons without a sound legal basis suggests that in this context it may be unwise to rely solely on a court's ability to ferret out and dismiss meritless claims.[62] Currently, target managers sue first and ask questions later; there is little reason for them to temper their urge to exploit the tactical value of litigation against the bidder, since at worst they face dismissal of their claims for lack of merit. The resulting cost is real and substantial: courts and lawyers must devote a good deal of their time and resources to lawsuits that are ultimately determined to be frivolous.[63] Accordingly, even if one is satisfied that courts are sufficiently vigilant and sophisticated to make

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59. Conceivably, however, managers intent on pursuit of their own interests could offer to terminate litigation in exchange for side payments (such as retention of their positions with the target) from the offeror. *See* Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers,* 98 HARV. L. REV. 1693, 1743 (1985). For self-interested target managers, therefore, the use of litigation as a "bargaining chip," *see* 1 A. FLEISCHER, *supra* note 8, at 301; Cherno & Sussman, *supra* note 36, at 44, may be tactically valuable as a means of resisting at least some of the consequences (such as the ouster of incumbent management) of a successful takeover. *See* note 35 *supra* and accompanying text (discussing target management's conflict of interest in takeover situations).

60. *See* 1 A. FLEISCHER, *supra* note 8, at 301; Cherno & Sussman, *supra* note 36, at 44. Of course, this is unlikely to be a useful strategy unless target management's claims are nonfrivolous, which is often not the case with target litigation. Moreover, if the asserted cause of action does have real merit, that may complicate the target's ability to bargain with the bidder; legitimate claims may prompt government interest or otherwise present obstacles to a takeover (*e.g.*, real concerns regarding substantive legal requirements, *see* notes 36-40 *supra* and accompanying text) that will not disappear simply because the target managers drop their lawsuit. Sophisticated managers, recognizing this, often find that the optimal strategy is to *threaten* litigation. *See, e.g.*, 1 A. FLEISCHER, *supra* note 8, at 265 n.98.

61. *See* notes 12-16 *supra* and accompanying text.

62. *See* notes 24-29 & 36-60 *supra* and accompanying text.

63. *See* notes 13, 16, 28 & 29 *supra*; *see also* notes 144-54 *infra* and accompanying text (discussing other costs of target lawsuits).

the right determinations most of the time,[64] preserving target management's incentive to file frivolous suits seems wasteful and unwarranted. It is partly for this reason that I propose, in Part III, reforms that would recognize and temper management's conflict of interest in suits against bidders.

B. *The Effectiveness of Target Litigation in Defeating Hostile Bids: The Costs and Benefits*

1. *Does Litigation Help Target Managers Resist Unwanted Bids?*

Given that entrenched target managers are moved by a variety of tactical considerations to sue bidders, there remains the question whether litigation actually helps managers resist hostile takeover bids. For a variety of reasons, I conclude that it does.

First, whatever the *specific* reason for using a lawsuit tactically in a control contest,[65] one thing seems clear: the principal goal of litigious target managers is to maintain their company's independence and, derivatively, their own place in the corporate structure.[66] Although litigation, like other defensive measures,[67] often precedes a higher offer by the original or a subsequent bidder,[68] target managers sue bidders primarily to *thwart* takeover attempts.[69] One simple measure of the effectiveness of litigation as an anti-takeover device, therefore, is the frequency with which litigious target managers succeed in maintaining their control over the target.

Empirical studies suggest a significant success rate for litigating target managements. For example, in his study of one hundred litigious target defenses, Jarrell found that the target remained independent in twenty-one cases.[70] More strikingly, empirical evidence that I gathered for this Article suggests that litigation is the single most ef-

64. *See* notes 13 & 31 *supra* (describing the view of some commentators that courts are increasingly skeptical regarding target lawsuits); *see also* notes 24-29 *supra* and accompanying text.

65. For a discussion of the various strategic considerations that lead target managers to sue hostile bidders, see notes 36-60 *supra* and accompanying text.

66. As noted, Gregg Jarrell apparently disagrees. *See* Jarrell, *supra* note 4, at 152-53, 154-59; text accompanying note 9 *supra.* I discuss Jarrell's thesis at notes 92-143 *infra* and accompanying text.

67. *See* Gilson, *supra* note 2, at 868. *See generally* Bebchuk, *supra* note 10, at 1038-41 (discussing effect of auctioneering rule on takeover premiums).

68. *See* Jarrell, *supra* note 4, at 161-71. Jarrell argues that litigation is a significant cause of bidding contests for targets. As I discuss below, however, his data show only that *delay* of a first offer increases the likelihood of an auction; he does not closely analyze the relationship between litigation and delay. *See* notes 113-14 *infra* and accompanying text. I argue below that even if delay is desirable as a means of spurring an auction for the target, it may be achieved more cheaply and effectively than through litigation. *See* notes 115-25 *infra* and accompanying text.

69. *See* Part I *supra.*

70. Jarrell, *supra* note 4, at 153. Jarrell concedes that these cases are "difficult to square"

fective defense used by targets that successfully preserve their independence.

I examined a sample of fifty-three defeated hostile tender offers between 1973 and 1985 in which the target remained independent for at least one year.[71] From stories on each tender offer in the *Wall Street Journal*,[72] I determined that target managers employed defensive measures in forty-five cases,[73] thirty-nine of which included litigation

with his hypothesis that "the goal of target management is to increase the takeover price and not to drive away all bids." *Id.* at 152-53; *see* notes 100-11 *infra* and accompanying text.

Unfortunately, Jarrell does not examine the precise role of litigation in these twenty-one cases. Thus, his study does not reveal whether a target in a particular case owes its independence to management's lawsuit or to the effectiveness of other defensive measures. *See* note 20 *supra.* I attempt to address this distinction in my own study. *See* notes 72-76 *infra* and accompanying text.

71. The sample was originally compiled and later updated by Kidder, Peabody & Co. (Kidder) as part of a study it conducted to determine the wealth effects of successful takeover defenses. *See* Kidder, Peabody & Co., Summary of Defeated Hostile Tender Offers 1973-1985 (July 26, 1985). The original Kidder study was considered by the SEC's Advisory Committee on Tender Offers and has been critically analyzed by Frank Easterbrook and Gregg Jarrell. *See* Easterbrook & Jarrell, *Do Targets Gain From Defeating Tender Offers?*, 59 N.Y.U. L. REV. 277, 287-91 (1984).

I relied on the Kidder sample for two reasons. First, although commentators may disagree sharply regarding the implications of the Kidder study, *compare* Lipton II, *supra* note 1, at 1026 (arguing that the defeat of a hostile takeover attempt can lead to a wealth increase for target shareholders), *with* Easterbrook & Jarrell, *supra* (arguing that the Kidder study, properly analyzed, does not support Lipton's contention), *and* Dutt, *SEC Economist Slams Kidder's Widely-Used Takeover Analysis*, CORP. FIN. WEEK, Oct. 21, 1985, at 1, 9 (same), *and* Pound, *Takeover Defeats Hurt Stockholders: A Reply to the Kidder Peabody Study*, 4 MIDLAND CORP. FIN. J. 33 (1986) (same), the *sample* is reliable for my purposes, if one accepts the study's criterion for defeat of a hostile bid (*i.e.*, remaining independent for at least one year). *But see* Pound, *supra*, at 37 (arguing that a target's ultimate acquisition after a one-year period is inconsistent with a "successful" defense); Bradley, Desai & Kim, *The Rationale Behind Interfirm Tender Offers: Information or Synergy?*, 11 J. FIN. ECON. 183 (1983) (five-year horizon chosen to distinguish between successful and unsuccessful acquisition attempts). Moreover, even defining "defeat" more rigorously, to require target independence for at least *two* years, would exclude from the sample only seven contests, in five of which litigation did not figure significantly in target management's defense.

Second, because the Kidder sample consists almost entirely of takeover contests that were widely followed in the press, it was relatively easy to gather information regarding the defensive measures that were employed in all but a few contests in the sample. *See* note 72 *infra* (describing exclusion of three contests from my study). Copies of both the Kidder study and my study are on file with the *Michigan Law Review.*

72. The Kidder sample included 56 control contests. I excluded from my study three contests for which either no or very little information was available in the *Wall Street Journal.*

73. In the remaining eight cases, the bid was either withdrawn when the bidder learned of target management's opposition, or it expired without having attracted the requisite number of tenders. Since target managers in these cases generally opposed the bid on the ground that the price was inadequate, cases in the latter category imply that shareholders sometimes believe management's claim that the tender offer price is too low and therefore refuse to tender. For example, in some (but not most) cases, the bid may reveal previously unknown information that causes target shareholders to value their stock more highly. *See* Bradley, Desai & Kim, *supra* note 71, at 204-06; Jensen & Ruback, *supra* note 35, at 15-16; Bradley & Rosenzweig, *supra* note 3, at 1389 n.51 (rejecting "information hypothesis" as satisfactory explanation for most tender offer activity).

These eight cases (whatever their explanation) suggest that vigorous management opposition is not always necessary to defeat a takeover attempt. Obviously, this observation is potentially against the bidder.[74] In twenty-two of these thirty-nine cases, the bidder's defeat was the result, directly or indirectly, of relief granted by the court.[75] No other defensive measure accounted for as many as ten of the forty-five cases of successful target defense.

It therefore appears that litigation helps target managers fend off hostile bids in a significant number of cases.[76] But what about those cases in which the target does *not* remain independent? Is there some sense in which litigation can be said to be an "effective" defensive measure in those cases?

In one sense, litigation *is* a potent anti-takeover device even in contests that culminate in a change of control. I have already discussed how litigation might be used to delay an unwanted tender offer.[77] Delay, it turns out, correlates highly with multiple-bid contests (or auctions) for targets.[78] In other words, the longer a tender offer is delayed, the more likely it is that additional, higher bids for the target will emerge. It follows that target managers may use litigation, in effect, to stimulate competitive bidding for the target's shares.[79]

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quite significant to the ongoing debate regarding takeover defensive tactics. *See, e.g.*, authorities cited at notes 1 & 2 *supra.*

74. This evidence is at least consistent with my claim that litigation is part of most target defenses. *See* notes 12-23 *supra* and accompanying text. Of course, since my study is based on a sample of *successful* defenses, it provides no direct evidence on the frequency of target litigation in control contests generally.

75. In 10 cases, the court granted injunctive relief that effectively defeated the takeover bid. In the remaining 12 cases, the court granted relief that delayed execution of the tender offer beyond the usual 20-day waiting period prescribed by SEC Rule 14e-1, 17 C.F.R. § 240.14e-1 (1986). These delays appeared to contribute significantly to management's resistance, in most cases by providing managers the time they needed to mount their successful defense. In a few cases, the court-ordered delay evidently increased the risk of the offer sufficiently to convince the bidder to withdraw. *See* notes 41-42 & 47-50 *supra* and accompanying text. *See also* Empirical Research Project, *Defensive Tactics to Hostile Tender Offers — An Examination of Their Legitimacy and Effectiveness,* 11 J. CORP. L. 651, 700-01 & n.440 (1986) (reporting that outcome of control contests favored 60% of litigating targets but only 43% of nonlitigating targets in sample studied).

76. It would be interesting to know how often target defenses succeed in the absence of litigation; such data would provide a better sense of the particular role played by target lawsuits (as distinguished from management resistance in general) in defeating unwanted bids. *See* notes 20 & 70 *supra.* Litigation is so common a defensive response, however, that it is difficult to collect a reasonable sample of successful nonlitigious defenses. *See* notes 17-20 *supra* and accompanying text. *But see* note 75 *supra* (describing recent empirical study).

77. *See* notes 44-52 & 75 *supra* and accompanying text.

78. *See* M. Bradley, A. Desai & E. Kim, Gains from Corporate Acquisitions and Their Division Between Target and Acquiring Firms 3-4 (rev. ed. July 1986) (unpublished working paper); Jarrell, *supra* note 4, at 160-61, 171; *see also* Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance,* 84 COLUM. L. REV. 1145, 1178 n.95 (1984); Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers,* 23 J.L. & ECON. 371, 373, 388, 405 (1980).

79. Indeed, as noted earlier, Gregg Jarrell hypothesizes that this explains most target litigation. Jarrell, *supra* note 4, at 152-53, 154-59. *See* note 9 *supra* and accompanying text. *But see* notes 95-114 *infra* and accompanying text.

Provoking an auction is an effective means of resisting *an initial bid;* initial bidders usually fail to win control of target firms in multiple-bid contests.[80] But it is also true that targets rarely remain independent once an auction ensues: existing empirical evidence suggests that there are few multiple-bid contests among those tender offers in which the target is not ultimately taken over.[81] Thus, while litigation can help target managers retain control of their firm,[82] in many cases it may actually *facilitate* a change of control, albeit to a subsequent bidder at a price higher than the initial offer. In these cases, obviously, litigation is not ultimately helpful to entrenched target managers who wish to retain their positions.

It is also worth noting that, not surprisingly, shareholders of acquired firms fare significantly better in auctions than in single-bid takeovers. Gregg Jarrell, for example, concluded from his multimethod investigation of the returns to shareholders from competing bids that "auctions are quite lucrative for targets."[83] Other empirical studies support this observation.[84]

In view of this evidence, some might argue that target litigation is laudable. Indeed, the conclusion Jarrell draws from his study is that

> target litigation [is] a strategic weapon that benefits shareholders by delaying the execution of the offending offer. This delay increases the likelihood that a higher offer will be made by the original bidder or others. . . .
>
> . . . .
>
> . . . [L]itigating targets are very frequently the beneficiaries of delayed auctions or improved bids by the original suitors. The high frequency of these auctions and the large benefits they produce for target shareholders dominate the forgone losses [sic] in the cases where litigation helps to prevent takeovers. . . .
>
> This finding . . . suggests that most target litigation should be viewed as a value-maximizing gamble undertaken by managers in the best interests of their shareholders.[85]

80. *See, e.g.,* Ruback, *Assessing Competition in the Market for Corporate Acquisitions,* 11 J. FIN. ECON. 141, 147 (1983) (reporting a 75% failure rate for first bidders where a subsequent bid is made); M. Bradley, A. Desai & E. Kim, *supra* note 78, at 31 (reporting a 67% failure rate for first bidders).

81. For example, the sample of 26 defeated tender offers examined by Bradley, Desai & Kim, *supra* note 71, includes *no* multiple-bid contests. *See* MERC Tender Offer Database (available from Managerial Economics Research Center, University of Rochester Graduate School of Business Administration). My study of 53 defeated bids, *see* note 71 *supra,* includes 9 cases in which competing bidders appear to have been involved.

82. *See* notes 70-76 *supra* and accompanying text.

83. Jarrell, *supra* note 4, at 169.

84. *See, e.g.,* M. Bradley, A. Desai & E. Kim, *supra* note 78, at 21 ("[T]he rate of return to target stockholders [is] greater in multiple-bidder contests than in single-bidder cases."); Bebchuk, *supra* note 10, at 1038; Gilson, *supra* note 2, at 868 n.176.

85. Jarrell, *supra* note 4, at 152-53.

I believe, however, that Jarrell's conclusion is wrong. I suggest below that target litigation as a general matter is likely to be *harmful* to the interests of target shareholders.[86] At best, I will show, Jarrell presents an argument for delaying tender offers and thereby stimulating competitive auctions; it does not follow that litigation is the best way to obtain that delay. Even if delay-induced bidding contests are desirable, I argue that such delay can be accomplished more cheaply and directly by means other than target litigation.[87]

2. *Is Litigation in the Best Interests of Target Shareholders?*

Certain observations regarding takeover activity seem beyond dispute. First, shareholders of firms that are acquired in tender offers generally realize substantial gains.[88] Second, those gains are usually even greater if the acquisition follows an auction for the target.[89] Third, certain forms of target management opposition to takeover bids commonly elicit an auction;[90] notable among these, of course, is litigation that succeeds in delaying an initial bid.[91]

As I have noted, Gregg Jarrell concludes on the basis of these observations that litigation is in the interests of target shareholders.[92] Some would respond that permitting target managers to stimulate auctions is not, as a general matter, in the best interests of target shareholders.[93] These commentators suggest that allowing managers to elicit a bidding contest may raise the price received by target shareholders ex post, in a given transaction, but only by raising the expense anticipated by a potential bidder ex ante, thus reducing the number of expected wealth-increasing bids.[94] Such commentators might con-

86. *See* notes 95-143 *infra* and accompanying text.

87. *See* notes 115-25 *infra* and accompanying text.

88. *See* Jensen & Ruback, *supra* note 35, at 10-16 (summarizing empirical studies).

89. *See* notes 83-84 *supra* and accompanying text.

90. *See* notes 78-79 *supra* and accompanying text.

91. *See* authorities cited at note 52 *supra.*

92. *See* note 85 *supra* and accompanying text; *see also* Jarrell & Poulsen, *Shark Repellents and Poison Pills: Stockholder Protection — From the Good Guys or the Bad Guys?,* 4 MIDLAND CORP. FIN. J. 39, 40 (1986) (arguing that target litigation benefits target shareholders).

93. *See, e.g.,* Schwartz, *supra* note 10, at 229-30, 249-51; Easterbrook & Fischel, *Auctions and Sunk Costs in Tender Offers,* 35 STAN. L. REV. 1 (1982).

94. Commentators disagree sharply on whether an auction market generally increases target shareholder wealth. *Compare* Schwartz, *supra* note 10, *and* Easterbrook & Fischel, *supra* note 93 (arguing that the likelihood of bidding contests reduces the probability of an initial offer being made, which redounds to the detriment of shareholders), *with* Bebchuk, *supra* note 10, *and* Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense,* 35 STAN. L. REV. 51 (1982) (arguing that the possibility of an auction does not significantly deter initial bids). *See also* Coffee, *supra* note 78, at 1175-83 (essentially agreeing with Bebchuk and Gilson, on the ground that the market believes the demand curve for corporate control is inelastic); Carney, *Two-Tier Tender Offers and Shark Repellents,* 4 MIDLAND CORP. FIN. J. 48, 51-52 (1986) (argu-

clude, therefore, that Jarrell mistakenly overlooks the ex ante impact of target litigation. But one need not reach the auction question (however interesting and important it may be) in order to conclude that litigation is on balance harmful to target shareholders.

Even if Jarrell is correct that opposition to a takeover bid sometimes increases the wealth of target shareholders, his argument ignores the implications of target management's serious conflict of interest[95] and slights even his own empirical evidence.[96] He concedes that "remaining independent by thwarting [a] takeover attempt is never a beneficial outcome for target shareholders,"[97] and acknowledges that twenty-one percent of the litigious managements in his study (*i.e.*, twenty-one of the 100 in his sample) maintained their control over the target and thereby deprived their shareholders of substantial gains.[98] Yet he concludes that litigation is a "value-maximizing gamble"[99] that target managers undertake in their shareholders' best interests.

Jarrell's characterization of target litigation derives from his claim that the large gains from litigation-induced auctions[100] "dominate the forgone losses [sic] in the cases where litigation helps to prevent takeovers."[101] Consequently, his argument — that litigation is a value-maximizing gamble — is substantially weakened unless one believes

ing that Easterbrook and Fischel implicitly assume, incorrectly, that the supply curve for target shares is perfectly elastic); Leebron, *Games Corporations Play: A Theory of Tender Offers*, 61 N.Y.U. L. REV. 153, 205-14 (1986) (arguing that auctioneering rule increases *social* welfare by increasing supply of potential targets that invest in synergistic strategies). My purpose here is not to argue this point. Rather, as noted in the text, I believe that Jarrell is wrong *irrespective* of how one resolves the debate regarding competitive bidding.

95. *See* note 35 *supra* and accompanying text.

96. *Cf.* Gordon & Kornhauser, *Takeover Defense Tactics: A Comment on Two Models*, 96 YALE L.J. 295, 296-97 (1986):

> A successful auction means that target managers will possibly lose their jobs and certainly their autonomy. In adopting tactics that would tend to produce an auction, management may be hoping to thwart the takeover altogether. On the assumption that target management will act in a self-interested way, how should we distinguish tactics that will increase shareholder wealth from those that will not?

97. Jarrell, *supra* note 4, at 152. Jarrell relies on empirical studies showing that the price of target shares generally falls to its pre-offer level following an unsuccessful bid. *See id.* at 163, 171; Bradley, Desai & Kim, *supra* note 71, at 193-98; Easterbrook & Jarrell, *supra* note 71, at 283-84; Asquith, *Merger Bids, Uncertainty, and Stockholder Returns*, 11 J. FIN. ECON. 51 (1983); *see also* Pound, *supra* note 71 (rebutting suggestion of study by Kidder, Peabody & Co. that target shareholders benefit from defeat of hostile bids); Bradley & Rosenzweig, *supra* note 3, at 1389 n.51 (reviewing empirical evidence that while tender offer announcement results in significant increase in price of target shares regardless of offer's outcome, price increase is permanent revaluation only for targets ultimately taken over, with price increase for targets remaining independent dissipated over subsequent six months).

98. Jarrell, *supra* note 4, at 153, 171; *see also* note 75 *supra* and accompanying text.

99. Jarrell, *supra* note 4, at 153.

100. *See* notes 52 & 85 *supra* and accompanying text.

101. Jarrell, *supra* note 4, at 153.

that his twenty-one and my twenty-two[102] cases in which litigious targets avoided takeovers were unfortunate accidents. If they were inescapable accidents, they may well represent the price that must be paid for a system that *on average* benefits shareholders because it is more likely to provoke an auction than to thwart a takeover. If, however, the avoidance of takeover is not accidental, then one is challenged to devise a system that would preserve the benefits of stimulating auctions without incurring the costs of thwarting premium takeovers.

As I have suggested, it is almost certain that the avoidance of takeover by litigious targets is not accidental, that, indeed, avoiding takeover is management's clear goal in these cases. First, management's interest in retaining control is a powerful motive that must be recognized.[103] Second, the takeover defense literature suggests that if any outcome of vigorous management opposition is (from management's point of view) second best, it is provoking an auction that results in a successful subsequent bid. Specialists advise managers to use lawsuits in order to *resist* takeovers, even though they recognize that sometimes resistant target managers will eventually lose to a different bidder (or to a higher offer from the initial bidder).[104] Third, in cases that are not settled, target managers almost always lose.[105] As Jarrell recognizes, this "leaves us unsure about how often target managers would use legal victory to thwart the takeover completely. Perhaps many target managers capitulate and negotiate a takeover only because the courts refuse to protect them."[106]

Most troubling for Jarrell's thesis is the significant number of cases in which litigious managers actually preserve their control of the target. Jarrell says that this evidence requires a "qualification" of his hypothesis, to the effect that "[f]or many of these cases . . . remaining independent was the overriding goal of the defense. . . . [A]t least some actual takeovers would also have been thwarted if the legal battles had been won by the target managers."[107] But Jarrell's twenty-one and my twenty-two cases *contradict* rather than merely qualify his suggestion that litigation is usually a management gamble undertaken in the interests of target shareholders. The fact is that managers forsake substantial premiums in a large number of cases in which auc-

102. *See* note 75 *supra* and accompanying text.

103. *See* note 35 *supra* and accompanying text.

104. *See* authorities cited at notes 8 & 12-16 *supra.*

105. Jarrell, *supra* note 4, at 153.

106. *Id.*

107. *Id.*

tions do not develop and were unlikely to have been intended. Only if one attributes to managers the good-faith belief that remaining independent is beneficial for target shareholders despite the substantial short-term gains that are thereby sacrificed[108] — an attribution that over the run of cases appears plausible only if one ignores management's self-interest in preserving control[109] — is the proportion of cases in which litigation thwarts takeovers consistent with the "shareholder welfare theory of litigious defense."[110] In short, even if litigation is associated with auctions that increase target shareholder returns, it is difficult to believe that in the usual case target managers litigate with the intention of provoking an auction. Managers sue bidders hoping to defeat the bid;[111] if their hopes are realized (as they often are), the deleterious wealth effects for target shareholders may be substantial.

This alone suggests that litigation is too costly a means of stimulating auctions and is not, therefore, in the interests of target shareholders. But the case for target litigation seems even weaker when one examines more closely the relationship between litigation and auctions. Jarrell argues that litigation stimulates auctions. But his data show only that *target management opposition* correlates with competitive-bid contests. Thus, he assumes that opposition necessarily includes litigation and attributes the higher incidence of auctions in opposition cases to the lawsuits he imagines are part of every target defense.[112]

While I agree that litigation is quite often included in a resistant management's defensive arsenal,[113] it is impossible to know whether it is litigation, resistance generally, or something else that provokes auctions. All that the data (including Jarrell's) allow us to say with any confidence is that *delay* is associated with a high frequency of competi-

108. While some managers profess to believe that their shareholders will fare better in the long run if takeover is avoided, the evidence (including Jarrell's own findings) is compellingly the other way. *See* authorities cited at note 97 *supra*. The one study that purports to be to the contrary has been effectively discredited. *See* Easterbrook & Jarrell, *supra* note 71, at 287-91 (showing that study by Kidder, Peabody & Co. is in fact consistent with studies demonstrating that targets lose from defeating hostile bids, if one takes into account overall market movements); Dutt, *supra* note 71 (same); Pound, *supra* note 71 (same).

109. *See* note 35 *supra* and accompanying text.

110. Jarrell, *supra* note 4, at 152.

111. *See* authorities cited at notes 8 & 12-16 *supra; see also* notes 70-75 *supra* and accompanying text (describing evidence of the effectiveness of litigation in helping target managers fight off unwanted takeover attempts).

112. *See* Jarrell, *supra* note 4, at 160-61. Indeed, Jarrell's own conclusion is that "[t]arget litigation *(or public opposition)* and auction-style takeovers appear to be closely related phenomena . . . ." *Id.* at 161 (emphasis added); *see also* note 20 *supra*.

113. *See* notes 17-23 *supra* and accompanying text.

tive bid contests.[114] Jarrell's findings suggest that delay may be caused by target litigation in particular *or* by target opposition in general. Since he does not attempt to separate the two, we cannot conclude from his data that litigation is essential to the delay that correlates with a greater incidence of auctions. Given the real possibility that litigation may adversely affect target shareholder wealth, one might wish to learn more about the precise role of litigation in stimulating auctions before embracing Jarrell's thesis.

Moreover, even if we assume (not implausibly) that litigation plays a role in delaying tender offers and that delay is desirable because it facilitates bidding contests, it does not follow that target lawsuits offer a preferred method of securing such delay. I explain why in the next section.

3. *Is Target Litigation Desirable as a Means of Delaying Tender Offers?*

Litigation is very expensive. Indeed, takeover specialists often cite the cost of defending against lawsuits as a virtue of the litigation strategy.[115] One could undertake a careful study of the direct costs imposed by litigation on targets and bidders, but that hardly seems necessary. If delay is a virtue, it can be accomplished with a great deal less expense for both bidder and target. For example, the Securities and Exchange Commission could easily and directly delay takeover bids by amending Rule 14e-1[116] to extend the required minimum period for tender offers beyond twenty days.[117]

Some might oppose such an amendment, however, on the ground that greater delay would not always benefit target shareholders. Thus, amending rule 14e-1 as suggested might increase the risk and expense of *all* tender offers, possibly reducing the incidence of value-increasing bids.[118] More specifically, extended delay might disadvantage target shareholders in certain cases — for example, by scuttling the one bid

114. *See* authorities cited at note 78 *supra.*

115. *See* authorities cited at notes 8 & 12-16 *supra.* I speak here of the direct expenses of litigation to the litigants: attorneys' fees, management time spent on discovery requests and in court, and the like, although proper reckoning should also include the judicial resources that must be devoted to target suits. *See* note 63 *supra* and accompanying text. Below I discuss some of the larger social costs of target litigation. *See* notes 144-54 *infra* and accompanying text.

116. SEC Rule 14e-1, 17 C.F.R. § 240.14e-1 (1986).

117. The SEC's Advisory Committee on Tender Offers recommended such a change. *See* SECURITIES AND EXCHANGE COMMISSION ADVISORY COMMITTEE ON TENDER OFFERS, REPORT OF RECOMMENDATIONS, Recommendation 17 (July 8, 1983) (recommending extension of the minimum offering period to 30 days).

118. *Cf.* authorities cited at note 93 *supra* (arguing that permitting target managers to stimulate auctions is generally not in the best interests of target shareholders).

that has been made in circumstances in which additional bidders are unlikely to emerge. A possible virtue of litigation as a source of delay is that managers can *refrain* from suing if that seems desirable. Litigation, in other words, affords target managers the ability to trigger delay or not, as they deem appropriate.

Like Jarrell's thesis, however, this argument ignores the implications of target management's conflict of interest[119] and the empirical evidence of litigation's potency as an anti-takeover strategy.[120] Target litigation is in some sense like a game of Russian roulette; a lawsuit *may* simply delay an initial bid and provoke an auction, but given the motives of litigious target managers[121] and the role that litigation can play in defeating hostile bids, the risk that the lawsuit will instead deprive target shareholders of a large premium (and possibly block a value-increasing redeployment of the target's assets)[122] is quite high.

This risk could be substantially reduced without forgoing the perceived benefits of management-triggered delay by adopting a rule that would give target managers discretion to delay the consummation of a tender offer for some specified period, simply upon request. Rule 14e-1 might be amended in a slightly different manner, for example, to permit target managers to extend the minimum tender offer period on a showing that such a delay might help them secure a higher bid for the target.[123] By comparison, a lawsuit against the bidder seems very costly, for it not only involves substantial direct expense, but also carries with it the distinct possibility that a tender offer in the shareholders' interests will be thwarted and that no competitive auction will emerge.[124] Thus, if a principal justification for target litigation is its (assumed) role in delaying tender offers, that is scarcely any justification at all.[125]

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119. *See* note 35 *supra* and accompanying text.

120. *See* notes 70-74 *supra* and accompanying text.

121. *See* Part I *supra.*

122. *See* notes 144-48 *infra* and accompanying text.

123. *Cf.* Gilson, *supra* note 2, at 868-70 (arguing in favor of rules that would permit defensive tactics limited to the threat or success of securing a higher offer). Of course, one would presumably want to guard against management's self-interest by prescribing a maximum period of delay.

124. *See* notes 143-47 *infra* and accompanying text; *see also* notes 150-52 *infra* and accompanying text (discussing symbolic value of legal rules regarding target management resistance).

125. Proponents of target litigation might suggest an additional argument in its favor: target lawsuits help enforce legal rules that presumably embody societal goals. Thus, even assuming that litigating managers have impure motives, *see* note 35 *supra* and accompanying text, and that target lawsuits diminish shareholder wealth and impose significant costs on society, *see* notes 144-54 *infra* and accompanying text, target litigation, some would argue, can be socially valuable as a means of enforcing the law. *See* Yablon, *Contention Disclosure and Corporate Takeovers,* 6 CARDOZO L. REV. 429, 429-30 (1985). This, of course, is a variant of the familiar argument favoring standing for private attorneys general: a plaintiff's self-interest in prosecuting a claim vigorously can serve *society's* interests by furthering the policies that underlie the legal rule the

4. *Are There Other Benefits of Target Litigation?*

Commentators who support takeover defensive measures sometimes argue that certain measures are justifiable attempts to prevent bidders from either "raiding"[126] the target or exploiting the "prisoner's dilemma"[127] that often confronts target shareholders. Gregg

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plaintiff invokes. *See generally* Associated Indus. v. Ickes, 134 F.2d 694, 704 (2d Cir.), *vacated as moot*, 320 U.S. 707 (1943); Thayer, *Public Wrong and Private Action*, 27 HARV. L. REV. 317 (1914); *see also* Mills v. Electric Auto-Lite Co., 396 U.S. 375, 396 (1970); Newman v. Piggie Park Enter., 390 U.S. 400, 402 (1968); Frankel, *Implied Rights of Action*, 67 VA. L. REV. 553 (1981); Pitt, *Standing to Sue Under the Williams Act After* Chris-Craft: *A Leaky Ship on Troubled Waters*, 34 BUS. LAW. 117 (1978). To put this somewhat differently and more specifically, target litigation could be preferred as a means of promoting auctions, on the ground that target management will succeed in thwarting a takeover through a legal victory only where, by hypothesis, there is something illegal about the takeover effort.

There are at least two responses that may be made to this "private attorneys general" defense of target litigation. First, it is arguably the obligation of target management to promote the target shareholders' interests, rather than the interest of the public generally, in responding to a tender offer. Second, and more broadly, where private enforcement of the law exacts significant costs that may be avoided without sacrificing the law's objectives, the private attorney general notion seems less compelling. *See* notes 176-94 *infra* and accompanying text. This is particularly true if one suspects that the claims asserted by a particular class of private attorneys general are often without merit. *See* notes 13, 16, 28 & 29 *supra*. In any event, partly because of the potentially valuable private enforcement that target lawsuits can provide, I stop far short of proposing a ban on all target litigation. Rather, I merely suggest reforms that would recognize management's self-interest in this setting and thereby reduce the risks that currently inhere in such litigation. *See* Part III *infra*.

126. "Raiding" is the expropriation of target shareholder wealth through the acquisition of control over the target's resources for less than their fair market value. *See, e.g.*, Carney, *Shareholder Coordination Costs, Shark Repellents, and Takeout Mergers: The Case Against Fiduciary Duties*, 1983 AM. B. FOUND. RES. J. 341, 349 (1983); Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 307-09 (1983); *see also* Bradley & Rosenzweig, *supra* note 3, at 1409. *But see* note 128 *infra*.

127. The "prisoner's dilemma" in takeover situations is a function of the uncoordinated wealth-maximizing decisions that individual target shareholders make. Individual shareholders, acting in their self-interest and unable either to communicate or enforce agreements with fellow shareholders regarding their responses to a tender offer, may take action that reduces both their wealth and that of the other shareholders. Suppose, for example, a firm with 100 shares of common stock outstanding with a market price of $40 per share, or a total market value of $4000. Assume that a bidder offers $50 per share for 51 shares and $20 per share for the remaining 49 shares (a "front-end loaded, two-tier bid"), with the condition that the bid will be withdrawn if fewer than 51 shares are tendered. Under these circumstances, if the bid is successful, the bidder will acquire the target firm for $3530, which is less than its current value. Yet if target shareholders have homogeneous expectations, then each shareholder (acting independently) will tender in order to maximize his wealth: if he tenders, his wealth will be unaffected (if fewer than 51 shares are tendered), increase by $10 per share (if exactly 51 shares are tendered) or (at the extreme) decrease by $4.70 per share (if all 100 shares are tendered); if he holds, his wealth will either be unaffected (if fewer than 51 shares are tendered) or decrease by $20 per share (if at least 51 shares are tendered). In other words, in an unsuccessful offer, an individual shareholder's wealth will be unchanged whether or not he tenders. In a successful offer, his wealth loss will be $20 per share if he holds but at most $4.70 per share if he tenders. Since the decision of any single shareholder will not affect the outcome of the offer, the wealth-maximizing decision for each shareholder is to tender. As a result, the bid will succeed, even though all target shareholders would be better off if none tendered.

The example assumes that the price of target shares will remain at its pre-offer level if the bid is withdrawn. Empirical studies support this assumption. *See* authorities cited at note 97 *supra*. In addition, for simplicity I have omitted discussion of shareholder heterogeneity, coordination games that shareholders may play in these circumstances, and the impact of legal rules on front-

Jarrell seems to rely on these arguments to defend his thesis that litigation is consistent with the interests of target shareholders. Thus, he claims that litigation enables target managers to preclude bidders from manipulating the prisoner's dilemma to gain control of the target's assets for something less than their fair value.[128] Indeed, he asserts that litigation "can be *the most efficient means*"[129] of solving the prisoner's dilemma. I disagree.

First, Jarrell's concern with corporate raiding may be unjustified. The notion that bidders can gain control of targets with value-decreasing offers[130] is inconsistent with a competitive acquisitions market; competition in the market for corporate control should (in theory) protect target shareholders from bids that are successful at less than "the best takeover price."[131] Existing empirical evidence tends to support this hypothesis: studies show that target shares (including, it is important to note, those that are *not* purchased by the bidder) generally reflect significant capital gains as a result of successful tender offers.[132] There is no evidence to support the claim that bidders acquire targets through value-decreasing offers.

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end loaded, two-tier bids. For discussion of those refinements, and why they would not alter the example significantly, see Bradley & Rosenzweig, *supra* note 3, at 1391-93, 1397 n.68, 1415; *see also* M. Bradley & E. Kim, The Tender Offer as a Takeover Device: Its Evolution, The Free Rider Problem, and the Prisoner's Dilemma 18-26 (rev. ed. Apr. 1985) (unpublished working paper); Jensen & Ruback, *supra* note 35, at 31-32. *See generally* M. SHUBIK, GAME THEORY AND RELATED APPROACHES TO SOCIAL BEHAVIOR (1964).

128. Jarrell, *supra* note 4, at 156-57. His argument, essentially, is that litigation effectively provides for centralized decisionmaking with respect to tender offers: if management's lawsuit is a show-stopper, then obviously target managers have a veto power over the hostile bid; but even if the lawsuit is used only to delay the bid, that can benefit shareholders by eliciting higher offers. *See* notes 78-79 & 85 *supra* and accompanying text.

While Jarrell does not expressly mention corporate raiding, his concern with that possibility is implicit in his discussion of the prisoner's dilemma. Thus, his example describes a situation in which a bidder exploits the atomistic wealth-maximizing decisions of target shareholders to acquire the target for an effective price of $15 per share, despite the assumed availability of an offer worth $17 per share. Since he does not specify the target's pre-offer value, we cannot conclude that an acquisition price of $15 per share represents a "raid," as that term is commonly understood. *See* note 126 *supra*. Nevertheless, his point is that by solving the prisoner's dilemma, litigation ensures that the bidder will not acquire the target for less than "the best takeover price." Jarrell, *supra* note 4, at 156. If we think of "raiding" offers somewhat more broadly, to refer to bids that are value-decreasing relative *either* to the target's pre-offer market value *or* to some readily available value-increasing reallocation of the target's resources, then Jarrell may be understood to make the claim that I attribute to him. *See* Bradley & Rosenzweig, *supra* note 3, at 1418-21 & n.154 (discussing broader notion of corporate raiding).

129. Jarrell, *supra* note 4, at 157 (emphasis added).

130. *See* note 126 *supra*.

131. Jarrell, *supra* note 4, at 156.

132. *See, e.g.*, Bradley, Desai & Kim, *supra* note 71; Jensen & Ruback, *supra* note 35; Jarrell & Bradley, *supra* note 78; Bradley, *Interfirm Tender Offers and the Market for Corporate Control*, 53 J. BUS. 345 (1980). Concededly, these studies show only that target firms are not generally acquired for less than their pre-offer value. Thus, they do not actually refute Jarrell's claim that the prisoner's dilemma allows bidders to acquire targets for less than the "best" price. *See* note 128 *supra*. But even assuming *arguendo* that competition alone does not solve the prisoner's

On the other hand, Michael Bradley and I have observed elsewhere that competition among potential bidders may not be sufficient to protect target shareholders from value-decreasing acquisitions.[133] Essentially, we note that the incentives of firms to compete in the market for corporate control may be less than those that typically operate in other competitive markets. In most markets rents are competed away over time, and actors are induced to bid against one another in order to capture these rents in the short term. In the market for corporate control, where competition generally involves a series of revised bids, a potential competitor may be outbid without ever having purchased any target shares, and therefore without ever having captured any rents. Since the result of competition in this market may be to deprive *all* competitors (even the ultimate winner) of any of the gains from acquiring control of the target,[134] the incentives to compete may be significantly reduced, particularly given the nontrivial expense of revising a bid.[135]

Do these observations about competition in the market for corporate control suggest that Jarrell may be right after all? I think not. What they do suggest (as Bradley and I argue) is that mechanisms other than competition may be required to protect target shareholders. But of those that come to mind, allowing target managers to litigate seems the least desirable, in part because of the costs involved (both direct and indirect),[136] and in part because litigation, unlike other mechanisms one can imagine, often imposes on target shareholders the wealth-decreasing effects of remaining independent.[137]

For example, one might solve the prisoner's dilemma by adopting rules that allow target shareholders to tender either "approvingly" or "disapprovingly," with success of the bid dependent upon tender of a

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dilemma, it does not follow that litigation is "the most efficient means" of doing so. *See* notes 136-43 *infra* and accompanying text.

133. Bradley & Rosenzweig, *supra* note 3, at 1415-16; *see also* Bradley & Rosenzweig, *Defensive Stock Repurchases and the Appraisal Remedy*, 96 YALE L.J. 322, 334-35 (1986).

134. On the other hand, even a losing bidder will capture *some* rents if it has "hedged" by purchasing target shares in the open market; such shares can be sold at a profit to the winning bidder. *See* Gilson, *supra* note 94, at 53-54; Gilson, *supra* note 2, at 871-72; Bebchuk, *supra* note 10, at 1034-38; *see also* STUDY OF THE CHIEF ECONOMIST, *supra* note 19, table 9 (reporting average pre-offer target holdings of 18% by any-or-all bidders, 5% by two-tier bidders, and 12% by partial bidders in the period 1981 through 1984).

135. *See also* Carney, *supra* note 94, at 50 (arguing that "sunk cost" problems may deter entry of subsequent bidders); Leebron, *supra* note 94, at 196-97 (arguing that budgetary constraints and possibility of sequential auctions may reduce the incentive of a potential bidder to compete for control of a particular target).

136. *See* notes 104-08 & 114-23 *supra* & notes 149-53 *infra* and accompanying text.

137. *See* notes 70-75, 97-98 & 119-21 *supra* and accompanying text; *see also* notes 144-48 *infra* and accompanying text (arguing that litigation often impedes efficient reallocations of target assets).

certain number of "approving" tenders.[138] As Lucian Bebchuk has argued, this would disable bidders from exploiting the pressures and distortions to which target shareholder decisions are currently subjected without preventing value-increasing bids from reaching the shareholders.[139] Moreover, the costs of such a mechanism would almost certainly be less than those associated with target litigation.[140]

Alternatively, allowing target managers to make self-tender offers in response to hostile bids would, if subject to certain conditions, facilitate the defeat of value-decreasing bids without empowering managers to veto value-increasing offers.[141] Again, this mechanism appears to involve significantly less expense than litigation.[142]

In sum, even if one believes that the prisoner's dilemma poses a real problem in takeover situations, that does not appear to justify target litigation. The presumed benefits of litigation can be better and more cheaply accomplished through other means.[143]

5. *The Social Cost of Target Lawsuits*

Thus far I have considered mainly the *direct* expense of litigation. Arguably, the more serious drawback to target lawsuits is the *social cost* they can impose. I conclude this Part by turning briefly to a discussion of that cost.

As a general proposition, competitive markets facilitate the allocation of resources to their highest-valued uses. Some commentators see takeover battles as a particular illustration of this principle. They view the hostile tender offer as a transaction in the competitive market for corporate control, in which managers of the bidding and target firms vie for the right to control allocation of the target's assets.[144] Under

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138. *See, e.g.,* Two-Tier Tender Offer Pricing, Exchange Act Release No. 21079, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,637, at 86,919 (June 21, 1984); Bebchuk, *supra* note 59, at 1747-88.

139. Bebchuk, *supra* note 59, at 1747-55.

140. The direct costs of this mechanism seem relatively small, *see id.* at 1748-49, and it would impose none of the social costs that can arise from unfettered litigation by self-interested target managers. *See* notes 144-54 *infra* and accompanying text.

141. *See* Bradley & Rosenzweig, *supra* note 3, at 1412-28 (arguing that allowing defensive self-tenders, subject to requirements that they be nondiscriminatory and for no fewer than the number of shares being sought by the bidder, assures that control-winning bid will be made by management team that can maximize the value of the target).

142. *See* Bebchuck, *supra* note 59, at 1742-44; notes 144-54 *infra* and accompanying text.

143. *See also* Carney, *supra* note 126 (proposing use of fair-price charter amendments as lowest-cost response to value-decreasing two-tier bids).

144. *See, e.g.,* Bradley & Rosenzweig, *supra* note 3, at 1408-12; Jensen & Ruback, *supra* note 35, at 6; Bradley, *supra* note 132. These commentators recognize that the gains that accrue to target shareholders, *see* note 88 *supra* and accompanying text, may derive from any of a number of sources; they do not assume that tender-offer gains generally result from the ouster of inefficient or self-dealing target managers (although they acknowledge that that may be true occasion-

such a view, two conclusions follow: (1) an important function of takeover activity is to promote an efficient allocation of corporate resources; and (2) that function cannot be performed unless the competition between rival management teams is a fair one.[145]

Target litigation can undermine this fair competition by conferring a significant advantage on target managers in control contests with outside bidders.[146] Significantly, no safeguard prevents target managers from using litigation to block value-increasing offers. Thus, we have already seen how self-interested managers may sue in order to retain their control of the target, even where a successful bid would plainly move the target's assets to a higher-valued use.[147] Alternatively, target managers may sue one bidder in order to facilitate an inferior offer from a competing bidder who promises the managers side payments or a more attractive deal.[148] The social cost of either result is substantial, for both produce suboptimal allocations of the target's resources. Requiring target managers to comply with standards that would address their conflict of interest might go a long way toward reducing this cost.

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ally). Instead, they favor a "general synergy theory," to the effect that the sources of takeover gains (*e.g.*, economies of scale and scope, combination of complementary resources, exploitation of market power) may vary from one transaction to the next. *See* Bradley & Rosenzweig, *supra* note 3, at 1409-11 (discussing alternative sources of takeover gains and rejecting notion of a general theory explaining tender offers); Gilson, *supra* note 2, at 853, 873-74; Bebchuk, *supra* note 10.

145. As Michael Bradley and I have argued, "fair competition among rival management teams can prevent acquiring firms from effecting value-decreasing takeovers and target managers from defeating value-increasing acquisitions." Bradley & Rosenzweig, *supra* note 3, at 1411.

146. Numerous courts have noted that target lawsuits against bidders can significantly tip the competitive balance in takeover battles. *See, e.g.*, Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 60 (2d Cir. 1985); Norlin Corp. v. Rooney Pace, Inc., 744 F.2d 255, 269 (2d Cir. 1984); Gearhart Indus. v. Smith Intl., Inc., 741 F.2d 707, 715 (5th Cir. 1984); Liberty Natl. Ins. Holding Co. v. Charter Co., 734 F.2d 545, 566 (11th Cir. 1984); Equity Oil Co. v. Consolidated Oil & Gas, Inc., 596 F. Supp. 507, 511, 514 (D. Utah 1983); Marshall Field & Co. v. Icahn, 537 F. Supp. 413, 416 (S.D.N.Y. 1982); Standard Metals Corp. v. Tomlin, 503 F. Supp. 586, 603 (S.D.N.Y. 1980); Gateway Indus. v. Agency Rent A Car, Inc., 495 F. Supp. 92, 101 (N.D. Ill. 1980). Relevant portions of these opinions are quoted at note 29 *supra*.

For recent decisions discussing more generally the importance of an "even playing field" in corporate control contests, see Edelman v. Fruehauf Corp., 798 F.2d 882 (6th Cir. 1986) (enjoining target managers from attempt to exempt leveraged buyout proposal from appraisal provisions, on ground that exemption would unfairly disadvantage competing interfirm bidder); Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 283 (2d Cir. 1986) (enjoining "lock-up option" on ground that it inappropriately favored one bidder); Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 184 (Del. 1986) (same with respect to "no-shop" provision).

For the argument that advantaging one management team in a control contest contravenes the neutrality principle embodied in the Williams Act, see Bradley & Rosenzweig, *supra* note 3, at 1406-08.

147. *See* notes 70-75 & 119-21 *supra* and accompanying text; *cf.* Bradley & Rosenzweig, *supra* note 3, at 1421-27 (proposing safeguards that would prevent target managers from using defensive self-tender offers to defeat value-increasing acquisitions).

148. Bebchuk, *supra* note 59, at 1743.

In addition, maintaining the status quo with respect to target litigation may impose a different, equally troubling cost on society. I have suggested that litigious target managers have complex motivations, but that management's self-interest in takeover settings can be overwhelming.[149] For example, managers can convince themselves in good faith that preserving the target's independence is in the best interests of its shareholders.[150] Similarly, they may readily accept the advice of lawyers to sue a bidder, without carefully scrutinizing the merits of the legal claims they intend to assert.[151] In both cases, the managers' belief that they are acting properly and in their shareholders' interests may be mistaken, because they may be responding (even if to some extent unknowingly) to the understandably strong urge to prevent their own ouster. The law can play an important role in this setting by reducing the likelihood that managers will make such mistakes. Conversely, there is significant symbolic value in legal rules that permit (or inadequately discourage) such conduct; managers may take comfort that society, through its legal order, supports their decision to resist takeovers through litigation.[152]

The cost thus imposed by current law is substantial, not only because it permits managers to behave in a self-regarding way, but also because it represents a missed opportunity to signal clearly to managers that society disfavors self-interested behavior. There may be other self-interested corporate conduct that legal rules cannot as effectively police.[153] Given the inherent limitations of legal rules, the regulation of undesirable conduct that is within the law's reach can be useful for communicating society's disapproval to those who operate beyond the law's compass. By inadequately moderating the conflict of interest that influences litigious target managers, we squander one opportunity to communicate such a message, perhaps at the same time tempting managers to behave self-interestedly in other settings. The resulting cost to society, while difficult to reckon in economic terms, may be considerable.

Accordingly, quite apart from the harm that target litigation can

149. *See* note 35 *supra* and accompanying text.

150. *See* note 108 *supra* and accompanying text.

151. *See* notes 8 & 12-16 *supra* and accompanying text. *But see* note 23 *supra* (discussing counsel's ethical obligation to reject groundless litigation).

152. *See* notes 155-57 *infra* and accompanying text (describing current judicial attitude toward takeover defensive measures, including target litigation). Moreover, the mentality that lawyers have helped to create regarding antitakeover lawsuits arguably reinforces this belief in target managers. *See* notes 8 & 12-16 *supra* and accompanying text. *But see* note 23 *supra.*

153. For example, transfer sales between parent and subsidiary corporations in which products are purchased at below-market prices or sold at above-market prices. *See* Bradley & Rosenzweig, *supra* note 3, at 1412 n.129.

cause target shareholders and society by impeding value-increasing takeovers,[154] I favor legal rules that would respond to management's conflict of interest and reduce its temptation to sue bidders without carefully determining that a lawsuit is actually justified. I discuss several such rules below, in Part III.

III. Mitigating Litigious Target Management's Conflict of Interest: Proposals for Reform

The courts have generally held that target managers are entitled to the protections of the business judgment rule when implementing takeover defensive measures; so long as managers act in good faith and with a rational business purpose, resisting a hostile tender offer will not subject them to liability for breach of their fiduciary obligations.[155] This general proposition has been applied to a number of specific defensive responses,[156] including target litigation.[157] Thus, existing legal rules encourage target lawsuits by insulating litigious target managers

154. *See* notes 144-48 *supra* and accompanying text.

155. *See, e.g.,* Radol v. Thomas, 772 F.2d 244, 256-57 (6th Cir. 1985); Panter v. Marshall Field & Co., 646 F.2d 271, 293-95 (7th Cir.), *cert. denied,* 454 U.S. 1092 (1981); Treadway Cos. v. Care Corp., 638 F.2d 357, 380-84 (2d Cir. 1980); Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 701-04 (2d Cir. 1980); Johnson v. Trueblood, 629 F.2d 287, 292-93 (3d Cir. 1980), *cert. denied,* 450 U.S. 999 (1981); *see also* authorities cited at note 1 *supra. But see* Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264 (2d Cir. 1986) (invalidating grant of lockup option as breach of directors' fiduciary duties); Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir. 1986) (affirming injunction against enforcement of shareholder rights plan adopted by target management); Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255, 265-66 (2d Cir. 1984) (narrowing circumstances in which business judgment rule will apply to takeover defenses); Minstar Acquiring Corp. v. AMF, Inc., 621 F. Supp. 1252, 1261 (S.D.N.Y. 1985) (shifting to target managers burden of showing propriety of defensive tactics in certain circumstances); Heckmann v. Ahmanson, 168 Cal. App. 3d 119, 214 Cal. Rptr. 177 (1985) (affirming issuance of preliminary injunction against recipient of "greenmail"); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) (holding that management's grant of lock-up option to one of two competing bidders constituted breach of fiduciary duty); Packer v. Yampol, No. 8432 (Del. Ch. Apr. 18, 1986) (LEXIS, State library, Del. file) (holding that directors undertaking action that increased likelihood of continued incumbency are not disinterested); Good v. Texaco, Inc., No. 7501 (Del. Ch. Feb. 19, 1985) (LEXIS, State library, Del. file) (holding that burden is on target's board to show good faith in connection with stock repurchase undertaken in face of possible control contest).

156. *See, e.g.,* Gearhart Indus. v. Smith Intl., Inc., 741 F.2d 707 (5th Cir. 1984) ("springing warrants"); Buffalo Forge Co. v. Ogden Corp., 717 F.2d 757 (2d Cir.) (sale of and lock-up option on treasury stock), *cert. denied,* 464 U.S. 1018 (1983); SEC v. Carter Hawley Hale Stores, 587 F. Supp. 1248 (C.D. Cal. 1984) (open market stock repurchases plus issuance of new preferred stock and sale of crown jewel), *affd.,* 760 F.2d 945 (9th Cir. 1985); Pogo Producing Co. v. Northwest Indus., No. H-83-2667 (S.D. Tex. May 24, 1983) (LEXIS, Genfed library, Dist file) (self-tender offer); Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623 (D. Md. 1982) (counter tender offer); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (discriminatory self-tender offer); Moran v. Household Intl., Inc., 500 A.2d 1346 (Del. 1985) (share purchase rights plan).

157. *See, e.g.,* Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir.), *cert. denied,* 454 U.S. 1092 (1981); Grumman Corp. v. LTV Corp., 533 F. Supp. 1385 (E.D.N.Y. 1982); Berman v. Gerber Prods. Co., 454 F. Supp. 1310 (W.D. Mich. 1978); Commonwealth Oil Ref. Co. v. Tesoro Petroleum Corp., 394 F. Supp. 267 (S.D.N.Y. 1975).

from liability for fiduciary breach. Target shareholders who lose substantial takeover premiums because of successful litigious defenses[158] have little legal recourse against their managers.

Some commentators have responded by arguing that target management's conflict of interest in control contests should preclude application of the business judgment rule and bar some[159] or all[160] takeover defenses. Writing without the benefit of Gregg Jarrell's work, all of these commentators who mention target litigation claim (without extended discussion) that it should be prohibited.[161] My analysis leads me to be sympathetic with this conclusion: litigation by takeover targets can adversely affect target shareholder wealth[162] and exact significant social costs.[163] Its asserted benefits, moreover, are largely illusory.[164] Accordingly, one can readily understand why some would deny target managers[165] standing to assert claims against hostile bidders.

Nevertheless, I believe that a flat prohibition of target litigation would be dangerously (and needlessly) radical. Thus, even assuming that target managers are often inappropriate plaintiffs and that management-asserted claims frequently tend to be frivolous, hostile bidders do sometimes violate the law and thereby inflict real harm on the target firm or its shareholders.[166] If we bar direct target actions against the bidder, who will protect the target and its shareholders against such truly illegal conduct? More broadly, if we eliminate targets as plaintiffs, can we look to other private plaintiffs to help enforce the law?[167]

One possible answer is to rely on actions by target shareholders. Shareholder litigation, however, is fraught with problems of its own. First, shareholder actions (whether direct or derivative)[168] may in-

158. *See* notes 70-75, 97-98 & 120-21 *supra* and accompanying text.

159. *See* Bebchuk, *supra* note 10; Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, 35 STAN. L. REV. 23 (1982); Cohn, *supra* note 16; Gilson, *supra* note 2; Gilson, *supra* note 94.

160. *See* Easterbrook & Fischel, *supra* note 2; Easterbrook & Fischel, *supra* note 93; Schwartz, *supra* note 10.

161. Bebchuk, *supra* note 10, at 1029; Bebchuk, *supra* note 59, at 1743; Easterbrook & Fischel, *supra* note 2, at 1192-94; *see also* Gilson, *supra* note 2, at 878-79; Leebron, *supra* note 94, at 217-19.

162. *See* notes 97-98 & 120-22 *supra* and accompanying text.

163. *See* notes 144-54 *supra* and accompanying text.

164. *See* notes 95-143 *supra* and accompanying text.

165. *See* note 11 *supra*.

166. *See, e.g.*, authorities cited at note 36 *supra*.

167. *See* note 125 *supra*.

168. Both the common law, *see, e.g.*, Ross v. Bernhard, 396 U.S. 531, 534-35 (1970), and modern state corporation codes, *see, e.g.*, N.Y. BUS. CORP. LAW § 626 (McKinney 1986); DEL.

volve conflicts of interest that are at least as intractable as those that infect actions by target managers. Thus, because the law has responded to the "free-rider" problem of shareholder litigation by permitting the recovery of attorneys' fees and expenses in actions that confer a benefit on the corporation in question,[169] the incentive to

CODE ANN. § 327 (1983); MODEL BUS. CORP. ACT § 7.40 (1986), authorize shareholders to sue derivatively on behalf of their corporation to redress corporate injuries. *See also* FED. R. CIV. P. 23.1. While we usually think of derivative actions as a means of enforcing management's fiduciary obligations, *see, e.g.,* Fischel & Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis,* 71 CORNELL L. REV. 261 (1986); Coffee, *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation,* LAW & CONTEMP. PROBS., Summer 1985, at 5 [hereinafter Coffee, *Unfaithful Champion*]; Scott, *Corporation Law and the American Law Institute Corporate Governance Project,* 35 STAN. L. REV. 927 (1983); Coffee, *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working,* 42 MD. L. REV. 215 (1983) [hereinafter Coffee, *Rescuing the Private Attorney General*]; Coffee & Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform,* 81 COLUM. L. REV. 261 (1981); PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, Part VII (Tentative Draft No. 6, 1986) [hereinafter ALI CORPORATE GOVERNANCE PROJECT], they have always been available for the assertion of claims against third parties as well. *See* United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261 (1917); Corbus v. Alaska Treadwell Gold Mining Co., 187 U.S. 455 (1903); Hawes v. Oakland, 104 U.S. 450 (1882). It is therefore clear that target shareholders can use derivative actions to assert legal claims on the company's behalf against hostile bidders. *See generally* ALI CORPORATE GOVERNANCE PROJECT, *supra,* § 7.07.

Of course, it is axiomatic that shareholders may bring derivative actions only to vindicate rights belonging to the *corporation. See generally* W. CARY & M. EISENBERG, CORPORATIONS 896-99 (5th ed. unabr. 1980); H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 360 (3d ed. 1983); ALI CORPORATE GOVERNANCE PROJECT, *supra,* § 7.01. Shareholders asserting their own personal rights must do so in *direct* actions. *See, e.g.,* Eisenberg v. Flying Tiger Line, 451 F.2d 267 (2d Cir. 1971); Knapp v. Bankers Sec. Corp., 230 F.2d 717 (3d Cir. 1956); Reifsnyder v. Pittsburgh Outdoor Advertising Co., 405 Pa. 142, 173 A.2d 319 (1961).

Since certain acts may simultaneously injure a corporation and impair the rights of its shareholders, in practice the distinction between derivative and direct actions is often unclear. *See, e.g.,* Snyder v. Epstein, 290 F. Supp. 652, 655 (E.D. Wis. 1968); Bennett v. Breuil Petroleum Corp., 34 Del. Ch. 6, 15-16, 99 A.2d 236, 241 (1953); Borak v. J.I. Case Co., 317 F.2d 838, 844-45 (7th Cir. 1963), *affd.,* 377 U.S. 426, 431 (1964). Nevertheless, the claims that targets currently bring directly generally allege corporate injury; if they did not, target standing would be more problematical. (Indeed, courts that deny targets standing to assert Williams Act claims often base their decisions on the implicit view that the Williams Act protects target shareholders, not the target itself or its managers. *See, e.g.,* Liberty Natl. Ins. Holding Co. v. Charter Co., 734 F.2d 545, 558-59 (11th Cir. 1984); Equity Oil Co. v. Consolidated Oil & Gas, Inc., 596 F. Supp. 507 (D. Utah 1983); Leff v. CIP Corp., 540 F. Supp. 857 (S.D. Ohio 1982); Marshall Field & Co. v. Icahn, 537 F. Supp. 413 (S.D.N.Y. 1982); First Ala. Bancshares Inc. v. Lowder, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,015 at 91,249 (N.D. Ala. 1981); Gateway Indus. v. Agency Rent A Car, Inc., 495 F. Supp. 92 (N.D. Ill. 1980); Sta-Rite Indus. v. Nortek, Inc., 494 F. Supp. 358 (E.D. Wis. 1980); Treadway Cos. v. Care Corp., 490 F. Supp. 660 (S.D.N.Y.), *modified,* 638 F.2d 357 (2d Cir. 1980); Nicholson File Co. v. H.K. Porter Co., 341 F. Supp. 508 (D.R.I. 1972), *affd.,* 482 F.2d 421 (1st Cir. 1973).) Accordingly, most of these target claims would be viewed as derivative if asserted by shareholders. Moreover, even if an action were less obviously derivative (for example, an action for Williams Act violations), unless it unambiguously asserted rights that were *exclusively* personal to the shareholders, the shareholder plaintiffs could choose to bring either a direct or a derivative action or both simultaneously. *See, e.g.,* W. CARY & M. EISENBERG, *supra,* at 898; ALI CORPORATE GOVERNANCE PROJECT, *supra,* § 7.01 reporter's note 6.

169. *See, e.g.,* Bosch v. Meeker Coop. Light & Power Assn., 257 Minn. 362, 101 N.W.2d 423 (1960); Denney v. Phillips & Buttorff Corp., 331 F.2d 249 (6th Cir. 1964); Tanzer v. Huffines, 345 F. Supp. 279 (D. Del. 1972). *See generally* Hornstein, *The Counsel Fee in Stockholder's*

bring shareholder suits belongs more to the plaintiff's *lawyer* than the plaintiff himself. As a consequence, the relevant private enforcer in shareholder actions is someone whose interests may be adverse to the very shareholders he nominally represents.[170] Plaintiff's attorney, for example, may be induced to accept collusive settlement of a claim that effectively trades a low corporate recovery for a high fee award.[171] Moreover, lawyers may find it in their interest to assert frivolous claims entirely for their settlement value (the familiar "strike suit").[172]

Recall that I criticized target lawsuits partly on the ground that management's conflict of interest can cause it to litigate principally for tactical reasons, resulting in the frequent assertion of meritless claims against bidders. The foregoing analysis suggests that the lawyer, the real plaintiff in shareholder suits, is influenced by his own conflict of interest and may also find the temptation to assert frivolous claims irresistible. As a result, one might legitimately question whether shareholder actions represent a superior means of enforcing legal claims against bidders.[173]

Derivative Suits, 39 COLUM. L. REV. 784 (1939); Hornstein, *Problems of Procedure in Stockholder's Derivative Suits,* 42 COLUM. L. REV. 574 (1942); Hornstein, *New Aspects of Stockholders' Derivative Suits,* 47 COLUM. L. REV. 1 (1947); Hornstein, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards,* 69 HARV. L. REV. 658 (1956); Mowrey, *Attorney Fees in Securities Class Action and Derivative Suits,* 3 J. CORP. L. 267 (1978); Leubsdorf, *The Contingency Factor in Attorney Fee Awards,* 90 YALE L.J. 473 (1981); Coffee, *Rescuing the Private Attorney General, supra* note 168; W. CARY & M. EISENBERG, *supra* note 168, at 938-43; ALI CORPORATE GOVERNANCE PROJECT, *supra* note 168, § 7.18 comment a. The most recent draft of the ALI Corporate Governance Project describes as "widely accepted" the following explanation for the rule regarding attorneys' fees and expenses:

> Because individual shareholders would find it infeasible to organize and tax themselves the costs necessary for a successful action, the well-established rule that a successful plaintiff may look to the corporation for reimbursement of his fees and expenses is a precondition to an effective litigation remedy. In effect, this rule represents the common law's efficient solution to the well-recognized "free rider" problem that arises whenever an individual must incur costs to benefit a group of which he is a member. Unless some mechanism exists by which to allocate these costs among the group in proportion to the respective benefits to be received, the individual (here, the plaintiff shareholder) has an inadequate incentive to proceed.

Id. at 224-25.

170. *See, e.g.,* Fischel & Bradley, *supra* note 168, at 271 (noting that plaintiff's attorney "has very little incentive to consider the effect of the action on [the] shareholders, the supposed beneficiaries, who ultimately bear the costs"); Coffee, *Rescuing the Private Attorney General, supra* note 168, at 232 ("[T]he plaintiff's attorney is subject to a serious conflict of interest . . . ."). *See generally* Coffee, *Unfaithful Champion, supra* note 168; F. WOOD, SURVEY AND REPORT REGARDING STOCKHOLDERS' DERIVATIVE SUITS (1944).

171. *See generally* Garth, Nagel & Plager, *Empirical Research and the Shareholder Derivative Suit: Toward a Better-Informed Debate,* LAW & CONTEMP. PROBS., Summer 1985, at 137.

172. *See, e.g.,* Surowitz v. Hilton Hotels Corp., 383 U.S. 363, 371 (1966); *see also* Coffee, *Unfaithful Champion, supra* note 168, at 13, for an economic analysis of why lawyers find it worthwhile to bring frivolous actions. *See generally* Coffee, *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions,* 86 COLUM. L. REV. 669 (1986).

173. For proposals designed to align more closely the interests of derivative and class action lawyers and their clients, see ALI CORPORATE GOVERNANCE PROJECT, *supra* note 168, § 7.18

In addition, a rule barring target lawsuits but permitting actions by target shareholders would cause unnecessary conceptual strain. For example, how, under such a rule, would courts treat lawsuits in which the plaintiff-shareholder is also a manager? In certain such cases, it may be obvious that the "shareholder" action is a spurious attempt to circumvent the rule barring management suits,[174] but in other cases making that judgment would be more difficult.[175]

Similarly, it is not clear that a rule barring management suits against bidders could effectively prevent managers from finding a third-party plaintiff to sue on their behalf. However the rule might be phrased, it seems certain that some covert system of signals would be available by which management could secure the services of a plaintiff's attorney (or, perhaps more likely, an institutional law firm that could find a group of shareholders to "protect").

A more promising avenue of reform, therefore, might be to continue to permit management suits, but to subject litigious target managers to certain rules designed to mitigate their self-interest. One such solution, for example, might be to outlaw all defensive responses except litigation.[176] Under such a regime, target lawsuits would be less useful tactically, since delay would no longer afford managers the opportunity to erect other barriers against takeover.[177] Thus reducing the tactical value of litigation might decrease the incidence of meritless suits[178] and also significantly disable managers from successfully resisting premium tender offers.[179] Moreover, this approach would preserve the target's ability to prevent or redress truly illegal conduct by bidders.[180]

But this modified "rule of passivity"[181] would not entirely elimi-

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comment g; Coffee, *Rescuing the Private Attorney General, supra* note 168; Coffee, *Unfaithful Champion, supra* note 168.

174. *Cf.* Piper v. Chris-Craft Indus., 430 U.S. 1 (1977) (denying bidder standing, *qua* target shareholder, to sue competing bidder for damages under § 14(e) of the Williams Act).

175. At a certain level of share ownership, for example, it would be hard to argue that a shareholder who happens also to be a manager should be barred from asserting a claim *qua* shareholder.

176. *Cf.* Baron, *supra* note 10, at 342 (proposing ban on all defensive measures); Easterbrook & Fischel, *supra* note 2, at 1198 (same); Gilson, *supra* note 2, at 878-79 (proposing ban on all defensive measures except those that might facilitate an auction for the target's shares); Bebchuk, *supra* note 10, at 1029 (same).

177. *See* notes 44-52 & 75 *supra* and accompanying text.

178. *See* notes 13, 16, 28 & 29 *supra* and accompanying text.

179. *See* authorities cited in note 177 *supra* (discussing utility of delay in resisting hostile bids).

180. *See* note 125 *supra;* notes 166-67 *supra* and accompanying text.

181. *Cf.* Easterbrook & Fischel, *supra* note 2, at 1201 (proposing a "rule of passivity" forbidding management from employing any defensive tactic, including litigation).

nate the tactical value of litigation,[182] and even if it did, such a rule seems, in Professor Coffee's words, "an increasingly futile hope."[183] Moreover, it could in fact backfire. If litigation were the only tactic that target management could invoke to thwart tender offers, *more* barely colorable lawsuits might be brought for want of other options. A less extreme solution may therefore hold greater promise.

For instance, target managers who sue hostile bidders could be denied the protections of the business judgment rule[184] and instead be required to demonstrate the compelling business purpose of their lawsuit.[185] This more stringent standard would discourage managers from suing reflexively in an effort to thwart unwanted tender offers. As with the modified passivity rule described above, the result might be to reduce the likelihood of both frivolous litigation and the defeat of

182. Target managers, for example, might still be tempted to sue bidders in the hope that their lawsuit might be a "show-stopper." *See* notes 36-42 *supra* and accompanying text. While the increasing reluctance of courts to enjoin tender offers (even preliminarily) makes this result less likely than it once was, *see* notes 24-31 *supra* and accompanying text, and while "show-stoppers" are rare where the target's lawsuit is purely tactical, *see* note 43 *supra* and accompanying text, self-interested managers would have little reason to refrain from suing.

Similarly, other strategic considerations that induce target managers to litigate would be largely unaffected by the suggested passivity rule. *See* notes 52-60 *supra* and accompanying text; *see also* notes 49-50 *supra* and accompanying text (noting that delay, by itself, can help defeat unwanted bids).

183. Coffee, *supra* note 23, at 15.

184. *See* notes 155-57 *supra* and accompanying text.

185. Or, to put this more broadly, the propriety of target suits could be judged by reference to management's duty of loyalty rather than its duty of care. *See generally* Cohn, *supra* note 16, at 498-501; Fischel, *supra* note 2, at 42-43; Lynch & Steinberg, *supra* note 47, at 925-28; *see also* Oesterle, *Target Managers as Negotiating Agents for Target Shareholders in Tender Offers: A Reply to the Passivity Thesis,* 71 CORNELL L. REV. 53, 69, 88-89 (1985) (proposing that target managers be required to show by clear and convincing evidence why acts designed to defeat a tender offer are in shareholders' best interests, but suggesting that managers able to prove by a preponderance of the evidence that a potentially "reversible" defense (such as litigation) was invoked only as a negotiating ploy be permitted to justify their actions by demonstrating by a preponderance of the evidence the reasonableness of their gamble).

Alternatively, section 6.17 of the most recent draft of the American Law Institute's Principles of Corporate Governance would protect director opposition to a hostile bid from injunctive or equitable relief upon a showing that "[a] reasonable investor would have believed that the holders of voting equity securities as a group would be likely to derive a greater present economic benefit as a result of the board's action than as a result of the pending or proposed tender offer." PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 6.17(a)(2) (Advisory Group Draft No. 7, 1986). The applicable standard for determining directors' *personal* liability for opposing a takeover bid would continue to be the business judgment rule. *Id.* § 6.18. Thus, as the comment to section 6.18 notes, under the ALI proposal "directors [would] have greater latitude in justifying their conduct if they [were] sought to be held personally liable for their actions . . . than if their actions [were] sought to be enjoined . . . . " *Id.* at 322.

To the extent that discouraging target suits might reduce the likelihood of litigation-induced auctions, *see* notes 44-52, 78-79 & 83-85 *supra* and accompanying text, a shift to one of these more stringent standards might seem more acceptable if accompanied by an amendment to SEC Rule 14e-1 providing for an extended period of management-triggered delay. *See* notes 116-25 *supra* and accompanying text; *see also* note 194 *infra.*

value-increasing bids. And again, under this approach managers could still pursue bona fide legal claims against bidders.

Nevertheless, courts have only recently begun to consider abandonment of the business judgment rule as the proper standard for evaluating takeover defensive measures.[186] Accordingly, at least until the courts demonstrate a greater willingness to subject defensive measures to a more rigorous test, it may make sense to consider other alternatives as well.

One broad response to target management's conflict of interest is suggested by Professor Coffee in his article in this issue.[187] His proposal — to compensate terminated managers through the use of "golden parachutes" — would plainly reduce management's incentive to resist hostile takeovers (although Coffee, to be sure, sees the termination bonus as a more broadly useful mechanism for preserving managers' incentive to develop firm-specific capital and safeguarding deferred managerial compensation).[188]

Coffee's proposal is appealing, not least because it seeks to abate target management's conflict of interest through positive rather than negative incentives.[189] His skepticism regarding the effectiveness of judicial oversight of management's defensive responses is plainly justified.[190] More particularly, he is surely correct that his equitable sharing approach would, among other things, lessen the burdens that are currently imposed by takeover litigation.[191] But Coffee himself recognizes that the optimal response to management's urge to resist hostile bids is to temper management's self-interest through negative *and* positive incentives.[192] I shall therefore conclude this Article by briefly describing two proposals that could (perhaps in conjunction

186. *See* authorities cited at note 155 *supra.*

187. Coffee, *supra* note 23.

188. *See id.* at 73-81.

189. *See id.* at 106; *see also* Jensen, *The Takeover Controversy: Analysis and Evidence,* 4 MIDLAND CORP. FIN. J. 6, 23-25 (1986) (arguing in favor of "golden parachutes" as a contractual solution to conflict-of-interest problem between managers and shareholders in change-of-control context).

190. Coffee, *supra* note 23, at 106; *see also* notes 62-64 *supra* and accompanying text.

191. *See* Coffee, *supra* note 23, at 107.

192. *Id.* at 106. Moreover, to the extent that managers placated by golden parachutes may be less likely to act to stimulate auctions, such provisions may impose substantial costs on target shareholders. While a manager with a golden parachute would be rewarded whether the company is taken over by the initial or a subsequent bidder, if the manager values the golden parachute more than he values control of the company he may prefer the former, since earlier rewards are worth more than later ones and an effort to stimulate an auction (through litigation, for example) could defeat the initial bid without enticing others to enter the bidding. *Cf. id.* at 107 (responding to claim that golden parachutes may be "indecent and even corrupting").

with positive incentives of the type described by Coffee) moderate litigious target managers' conflict of interest.

First, and most basically, one could impose cash penalties on target managers who assert frivolous claims. Rule 11 of the Federal Rules of Civil Procedure already authorizes courts to sanction lawyers who sign pleadings or motions that are without merit or interposed for an improper purpose (such as harassment or delay).[193] Enforcing a similar rule against target managers themselves might significantly alter their strategic calculus and thereby reduce their incentive to sue bidders for merely tactical reasons.[194] The result, arguably, would be a decrease in groundless target litigation and a declining use of lawsuits to resist value-increasing bids.

Alternatively, in recognition of target management's conflict of interest, managers might be required initially to finance target lawsuits out of their own funds, with reimbursement or indemnification available from the corporation upon a showing that the lawsuit was warranted.

Of course, what these proposals and the others discussed above share in common is their skeptical attitude toward target litigation: all, in one way or another, would treat target lawsuits with greater suspicion than actions brought by other plaintiffs. In the final analysis, taking this view of target litigation is more important than agreement on one proposal or another. Currently, the costs of target lawsuits far outweigh their benefits, principally because of the conflict of interest that influences litigious target managers. Tempering that conflict would blunt a costly takeover defense while preserving a valuable means of asserting meritorious legal claims against bidders. Ultimately, this would benefit not only target shareholders, but also society at large.

193. *See* note 23 *supra.* Indeed, greater judicial enforcement of rule 11 would go a long way toward solving the problems of target litigation discussed in this article. *See generally* Nelken, *Sanctions Under Amended Federal Rule 11 — Some "Chilling" Problems in the Struggle Between Compensation and Punishment,* 74 GEO. L.J. 1313 (1986); Note, *Dynamics of Rule 11, supra* note 23; S. KASSIN, AN EMPIRICAL STUDY OF RULE 11 SANCTIONS (1985).

194. *See* notes 36-61 *supra* and accompanying text. Moreover, since rejection of the business judgment rule, *see* notes 184-85 *supra* and accompanying text, would address the problem of frivolous target litigation only indirectly, imposing direct penalties for the filing of meritless claims would seem sensible even if the courts were to hold litigious managers to a higher standard. Of course, one would also want to preclude indemnification for any such penalty. *See generally* R. CLARK, CORPORATE LAW § 15.10 (1986).